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Analysis of Sasol Limited's 2020 Climate Change Report

Just Share briefing note September 2020

Key points

- Sasol's 2020 Climate Change Report is the company's second report which is aligned with the Recommendations of the Task Force on Climate-Related Financial Disclosures.

- Sasol states that it is "keen to play a leadership role in South Africa's energy transition". This commitment is undermined by the board's refusal to table shareholder-proposed climate risk-related resolutions.

- Sasol sets out a "Roadmap for achieving our 2030 target". The target, set in 2019, is to reduce absolute GHG emissions from its South African operations by at least 10%, off its 2017 baseline of 63,9Mt CO2e[1]. This target is not aligned with the goals of the Paris Agreement, but is "based on the probability of success of potential reduction opportunities, associated risks, economic viability and balance sheet capability to finance these activities". The company says that it is "in the process of defining a 2050 reduction ambition and roadmap", which it will communicate at Capital Markets Day in 2021.

- The roadmap outlines Sasol's plan for emission reductions to be achieved via energy and process efficiency, the introduction of renewable energy, asset disposals, and the replacement of coal with natural gas as a feedstock for the liquid fuel business.

- Sasol is relying heavily on the assumption that significant natural gas resources and infrastructure will become available by 2030. It does not provide any information about the likelihood of this being the case, or the associated costs. It also ignores the fact that it is far from settled that natural gas, also a fossil fuel, is a necessary or appropriate "transition fuel" in the shift to a low-carbon economy.

- Sasol has expanded its scenario analysis in the 2020 Report, but these scenarios are missing some crucial elements.

- Sasol has assessed its scope 3 emissions, which it estimates at 42,3Mt CO2e for 2019, or 39% of total GHG emissions. Confusingly, however, Sasol has removed scope 3 emissions from its calculation of total GHG emissions elsewhere in its reporting. It reflects total GHG emissions for 2019 at 66Mt CO2e, whereas total scope 1, 2, and 3 GHG emissions, according to Sasol's numbers, are in fact 108,8Mt CO2e.

[1] Million tons of carbon dioxide equivalent

Introduction

On 24 August 2020, Sasol Limited released its **2020 Climate Change Report for the year ended 30 June 2020**. This is the second report by the company which is aligned with the Recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD).

The TCFD has developed a voluntary framework for disclosing climate-related financial disclosures "that are consistent, comparable, reliable, clear, and efficient, and provide decision-useful information to lenders, insurers, and investors".[2] "Alignment" with the TCFD framework does not necessarily mean that all of the TCFD's recommendations have been applied.

The TCFD was established in recognition of the material financial risks and opportunities posed by the climate crisis, and the urgent need for better access to data which allows investors to "make better informed decisions on where and how they want to allocate their capital".

Sasol & climate risk-related shareholder resolutions

Sasol's climate change reports are an explicit acknowledgment of the serious financial risks that its carbon-intensive operations pose to investors, and CEO Fleetwood Grobler says that Sasol is "keen to play a leadership role in South Africa's energy transition".

This commitment is undermined by Sasol's refusal to table shareholder-proposed climate risk-related resolutions at its annual general meetings, denying its shareholders any say in the company's approach to climate risk disclosure and carbon emission reduction targets.

By blocking climate risk-related shareholder resolutions, which have been tabled annually at the annual general meetings of fossil fuel companies across the globe for at least five years, Sasol is able to control the pace and extent of its climate risk disclosures. This means that it can also dictate the pace at which it acts to tackle climate risk. This pace is still far too slow, exposing investors to further significant financial risk.

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GHG emission reduction targets & 2030 roadmap

In 2019 Sasol committed to "reduce by 2030 the absolute GHG emissions from our South African operations by at least 10%, off our 2017 baseline". **This target is not aligned with the goals of the Paris Agreement, but was, according to Sasol's 2019 Climate Change Report, "based on the probability of success of potential reduction opportunities, associated risks, economic viability and balance sheet capability to finance these activities"**.

The company says in its 2020 Climate Change Report (2020 Report) that it is "in the process of defining a 2050 reduction ambition and roadmap", which it will communicate at Capital Markets Day in 2021.

The 2020 Report states that Sasol has "reduced emissions by a total of ~2 Mt pa CO2e from 2017, through mitigation interventions and slightly lower production output during the lockdown".

[2] https://www.fsb-tcfd.org/

In July 2020 Sasol announced the sale of its Secunda oxygen plant to Air Liquide. The 2020 Report states that this plant is responsible for approximately 7Mt CO2e per annum. Sasol says that Air Liquide has "indicated its commitment to reducing the emissions associated with these units by at least 30 - 40% by 2030". These "potential reductions … focus on a combination of renewable energy utilisation and potential modernisation of the oxygen units".

More information is needed in order to be able to assess the viability of this commitment, and the impact that it would have on Sasol's emissions profile.

Sasol states that this asset sale will not impact on it achieving its committed 10% reduction ambition (from the 2017 baseline) by 2030.

Sasol's **"Roadmap to achieving our 2030 target"** envisages the following:

- A reduction in emissions of 4 - 5% between 2020 and 2025, driven by "energy and process efficiency" and the introduction of 300MW of renewable energy to reduce scope 2 emissions; and
- A reduction in emissions of 6 - 7% between 2025 and 2030 driven by:
    - Additional energy and process efficiency;
    - An additional 300MW of renewable energy;
    - Additional gas conversion capacity; and
    - Asset disposal and decommissioning.

Sasol has pinned much of the success of its 2030 emission reduction goal on the assumption that significant quantities of natural gas will become available before then. The 2020 Report states that "gas remains a critical enabler for our GHG reduction ambitions". However, Sasol itself acknowledges that "there are uncertainties surrounding gas supply, pricing, [and] infrastructure development".

Furthermore, Sasol's assertion that natural gas is a necessary and appropriate "transition fuel" is a contentious one. At the point of combustion, natural gas does have a smaller carbon footprint than other fossil fuels. However, methane is the primary component of natural gas. Methane is a greenhouse gas which is around 30 times more potent than CO2. Even small amounts of leaks associated with the extraction, transport and processing of natural gas can have a significant impact on emissions.

Scenario analysis[3]

Sasol has expanded its scenario analysis in the 2020 Report, modelling the potential demand for each of its products in four different scenarios relevant to its "base case" scenario. The base case reflects Sasol's "previous strategy" and sees global temperature increases of 2.5 to 3.5 degrees Celsius. In this scenario, there is "some growth in liquid fuel demand but decline in coal demand".

The "cooperative scenario" has global temperature increases of more than 2 degrees Celsius, with a "stronger decline in coal and liquid fuel demand" and "rapid growth in renewables due to policy, greater efficiencies and technology sharing".

[3] The TCFD recommends the use of scenario analysis as "an important and useful tool for an organization to use both for assessing potential business implications of climate-related risks and opportunities, and for informing stakeholders about how the organization is positioning itself in light of these risks and opportunities". It is important to remember that scenario analysis uses hypothetical constructs as a "tool to enhance critical strategic thinking". Scenario analyses are "not forecasts, predictions or sensitivity analyses". https://www.tcfdhub.org/scenario-analysis/

The International Energy Agency's Sustainable Development Scenario (IEA SDS) holds global temperature increases to 1.8 degrees Celsius and has a 66% probability of being achieved. In this scenario, there is a "high carbon price, large investment in new energy sector, rapid fall in coal and liquid fuel demand, and very rapid adoption of renewables".

Sasol's scenario analysis predicts a negative impact on earnings of more than 20% on all of its value chains under the cooperative scenario, and a negative impact on earnings of more than 50% under the IEA SDS – if the company were to make no changes to its previous strategy.

On the other hand, Sasol says that "by incorporating our 2030 roadmap into the base case, we see an improvement in earnings in the IEA SDS of ~15 – 20% and ~2 – 3% in the cooperative scenario".

Sasol's scenarios do not mention the impacts of physical risks to its operations from climate change, and no information is provided on how the company is incorporating physical risk into its financial forecasts and guidance. The importance of doing so is illustrated by the impacts of Hurricane Laura which made landfall near Sasol's Lake Charles Chemicals Complex on 27 August. As a result, the manufacturing facilities at Lake Charles were forced to shut down.

Sasol only provides information about the impact of the various scenarios on one metric (earnings) at one point in time (2030). Information about the impact on different metrics, including credit metrics, over a period of time, would better help investors to understand potential risks and opportunities.

Scope 3 emissions

Sasol has assessed its scope 3 emissions, i.e. indirect emissions not included in scope 2 that occur in its value chain. For example, Sasol's scope 3 emissions include emissions from the use of its sold products, like the combustion of liquid fuel; waste generated by its operations; waste disposal and treatment of sold products at the end of their life; and business travel and employee commuting.

Sasol estimates its scope 3 emissions for 2019 (scope 3 reporting currently lags by one financial year) at 42,3Mt CO2 equivalent, stating that this represents 39% of its total GHG emissions.

Confusingly, however, all of Sasol's 2020 reports reflect total GHG emissions for 2019 as approximately 66Mt CO2e – in which case scope 3 emissions would constitute 64% of total GHG emissions.

In fact, Sasol's total emissions (scope 1, 2 and 3) for 2019 are approximately 108,8Mt of CO2e, according to Sasol's figures. Sasol has not included scope 3 emissions in its total GHG emissions figure elsewhere in its reporting.

Industry associations and climate lobbying

The 2020 Report includes a section on "assessing alignment with industry associations". This responds to the TCFD recommendation that reporting entities should explain how an organisation's stated values and its public policy positions align.

A company should not, for example, express public support for a low-carbon energy transition while simultaneously being a member of industry associations which lobby government to weaken climate regulations.

The 2020 Report states that Sasol has assessed 11 of the industry associations it belongs to against "four key principles considered [by Sasol] as essential for responsible climate-related advocacy for this assessment":

- "Acknowledgment and support for climate science;
- Alignment to goals of the Paris Agreement;
- Support of carbon pricing that provides greater incentives for innovation and lower-carbon choices; and
- Development of low and lower-carbon energy solutions in the form of renewable energy, natural gas (as a transition fuel) and energy efficiency".

The 2020 Report then simply concludes, without providing any evidence, that all 11 assessed industry associations are aligned with Sasol's principles.

This is highly questionable given the role that some of the assessed associations have played in climate lobbying in South Africa, for example in lobbying government to delay or scrap the introduction of the carbon tax.

As Sasol itself acknowledges, there is minimal publicly available information provided by industry associations on their lobbying positions and activities. Without that information, the assessment that Sasol says it has undertaken is meaningless.

The company also does not disclose whether it is a member of other industry associations that it has not assessed against its "key principles".

The "four key principles" are themselves problematic, particularly because Sasol's own targets are not aligned with the goals of the Paris Agreement, and because the Paris Agreement does not explicitly envision the large-scale adoption of natural gas "as a transition fuel".

Executive incentives

Sasol's current "climate change executive remuneration objectives" are weak.

Short-term incentive targets are:

- the release of the 2030 emissions reduction roadmap and delivery of "associated milestones towards our 2030 target";
- delivering the "business construct" for the 600MW renewable energy project;
- energy efficiency improvement of 1% from 2020 to 2021; and
- release of the "2050 long-term ambition and roadmap".

The long-term incentive plan requires "the introduction of renewable energy linked to the 600MW RFI and aligned to the 2030 roadmap by June 2023".

The 2020 Report states that "the intention is, as we formalise our capital allocation and roadmap for 2050, to include more granular climate change targets into our 2022 STI and LTI plans".

Conclusion

In the 2020 Report, Sasol goes further than it did in 2019 in its acknowledgment and disclosure of climate risks. The report articulates Sasol's plans and ambitions more clearly, although the exclusion of scope 3 emissions from total emissions is inconsistent and perplexing.

However, Sasol's plans are simply not ambitious enough: even Sasol states that "the need for South Africa to move towards a lower-carbon economy, and to pursue an energy mix that supports this imperative, is of utmost importance".

CEO Fleetwood Grobler says that "in Southern Africa especially, emission reductions are complicated by society's need to balance the challenges for access to affordable energy, while simultaneously reducing poverty, unemployment and inequality."

This "precarious balancing act" narrative is one consistently taken by Sasol. It would have us believe that our current energy system is not only affordable (if climate-destructive), but is also contributing significantly to the alleviation of poverty, unemployment and inequality. The implication is that transitioning to a low-carbon economy will put all of these achievements at risk.

But it is not necessary to be an energy expert to know that our fossil fuel-based economy does not provide affordable energy to all, and that its ability to deliver societal improvements is limited at best.

The longer we cling to this system, the more uncompetitive our economy will become. If Sasol is serious about contributing to South Africa's just transition, it must come clean about the extent and speed of transformation required in its business, set emissions reduction targets that are aligned with the Paris Agreement, and properly incentivise its executives to achieve them.

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