

## ARC Ratings upgrades ENSE's rating to "BBB-" with Stable outlook, from "BB+" with Positive outlook

<b><u>ISSUER</u></b>	<b><u>ISSUE RATING</u></b>
Entidade Nacional para o Setor Energético, E. P. E.	<b>BBB-</b> Medium and Long Term (BBB-, with stable outlook)
<b><u>RATING DATE</u></b>	<b><u>NEXT REVIEW DATE</u></b>
9 September 2019	9 September 2020

ARC Ratings, S.A. (ARC Ratings) has upgraded to "BBB-", with Stable outlook, from 'BB+', with Positive outlook, the rating accorded to the EUR 360.0 million bond issued by Entidade Nacional para o Setor Energético, E. P. E. (ENSE), on 6 August 2008. This rating action is based on the sovereign rating upgrade in May 2019, in the context of a decrease of the company's net financial debt, recovery of oil prices in 2019 that is expected to be sustainable according to general forecasts, and, consequently, the recovery of the coverage of net financial debt by the reserves at market value. In addition, being a "State corporate entity", ARC Ratings assumes that if ENSE's monitoring activity of all energy sectors is not self-sustaining, it will benefit from Portuguese Government financing.

### **COMPANY PROFILE**

ENSE, formerly designated ENMC - Entidade Nacional para o Mercado de Combustíveis, E.P.E. and before that EGREP - Entidade Gestora de Reservas Estratégicas de Produtos Petrolíferos, E.P.E., was founded in 2004 and headquartered in Portugal, remains a State-owned entity and was assigned by law with the duty of being the Portuguese central stockholding entity in the acquisition and maintenance of the strategic portion of national emergency reserves of oil and oil products (its main activity).

In August 2018, within the reorganization of public entities with responsibilities in the energy sector in Portugal, the company's duty of supervision was enlarged to cover all energy sectors (including electricity and natural gas). ENSE still manages and monitors the storage activities for crude oil and its derivatives throughout the national territory, in order to guarantee and supply of crude oil and petroleum products, depending on consumption needs.

### **RATING RATIONALE**

The key rating drivers for ENSE's bond rating are:

- **Government ownership** – ENSE's share capital is wholly owned by the Portuguese Government and the bond has an ownership clause regarding the maintenance of this sole ownership by the Portuguese Government. Consequently, its rating is indirectly linked to the ratings of the Portuguese Republic (BBB / Stable / A-2), however there is no obligation of timely support, but the Portuguese Government, as is established in law, is ultimately responsible for ENSE's liabilities ("in the case of dissolution of ENSE, the State assumes any losses arising from the liquidation of assets, as well as the residual responsibilities").

- Favourable debt profile – ENSE's debt levels remain largely unchanged, still comprising solely the bond that is rated in an amount of EUR 360 million, maturing in 2028. Above all, ENSE's expenses (including bond interests) have been totally covered by revenues, mainly originated from the oil market operators. The investments in Portuguese Government issued debt securities increased and the cash position remained positive, allowing to decrease the company's net financial debt.
- Stable, long-term relationships with key customers – The entity has developed strong, mutually beneficial relationships with the main distributors of oil products in Portugal: Galp Energia, SGPS, S.A. (Galp Energia), Repsol, S.A. (Repsol), BP p.l.c. (BP) and Compañía Española de Petróleos S.A. (CEPSA).

The key constraints on ENSE's bond rating are:

- Oil price volatility and the coverage of the loan by reserves – The nature of ENSE's operations and concentration of its assets render its financial performance heavily exposed to oil price fluctuations. In fact, the oil price drop trend in the last two months of 2018, reaching the minimum price at the end of 2018, led the coverage of financial debt by reserves to decrease to 0.91 times (from 1.12 times at the end of 2017). However, the recovery of the oil price allowed this to improve coverage to 1.23 times at the end of March 2019 (the highest coverage achieved since 2014). The coverage of net financial debt by reserves was still above 1 times (1.07 times) at the end of 2018 and increased to 1.46 times at the end of March 2019 (compared with 1.31 times at the end of 2017).
- Concentration of customer base – Despite some decrease over 2018, compared to 2017, the majority of ENSE's revenue derived from five companies: Galp Energia (that represented 26% of ENSE's revenues in 2018), Repsol (24.2%), BP (close to 20%), Prio Supply, S.A. (10.5%) and CEPSA (9.5%).

## **RECENT DEVELOPMENTS AND OUTLOOK**

The total volume of oil products introduced for consumption in Portugal increased 2.3% in 2018, to 8.25 million tonnes (Mton), compared with an 2.9% increase in 2017. Increases in B (diesel) and D (liquefied petroleum gases - LPG) more than offset decreases registered in A (gasoline) and C (fuel oil) categories. The volume mix of oil products introduced for consumption in Portugal did not change materially, with the B category representing 78.5% and the A category 12.7%, while the D category accounted for 6.2% and the C only for 2.6%. In the context of the increase in the total volume of oil products introduced for consumption in Portugal, the required nation's minimum emergency reserves (90 days) and ENSE's strategic reserves (30 days) also increased 2.3% in aggregate in 2018, in aggregate, to 2,034.2 thousand tonnes (tton) and 678.1 tton, respectively.

ENSE slightly increased its own reserves to 938.6 tton at the end of 2018, while its reserves contracted under CSO Tickets (Compulsory Stockholding Obligation) slightly decreased to 301.5 tton, from respectively 938.1 tton and 303.5 tton at the end of 2017. Nevertheless, ENSE continued to present substantial headroom between its mentioned own reserves and the legally required strategic reserves (678.1 tton), with significant headroom in all categories, allowing ENSE to continue replacing part of the operators' own obligation.

The storage of ENSE's own reserves in Portugal continued to be carried out under agreements with Galp Energia (mostly stored near Galp Energia's oil refineries in Matosinhos, near Porto in the North of Portugal, and Sines, in the South of Portugal), and with the Portuguese Government (for the POL NATO deposits near Lisbon). ENSE is

studying storage alternatives, namely the possibility of future storage in caverns in Portugal, which presents some advantages due to their underground location. At the end of 2018, finished products represented 36.7% of the total stocks, compared with one third required by law.

ENSE - FINANCIALS AND RATIOS (THOUSAND EUROS)

	2014	2015	2016	2017	2018	2018 Jan to Mar	2019 Jan to Mar	2019 (F)	2020 (F)
<b>TURNOVER</b>	79,747	24,562	24,331	25,398	24,266	5,988	6,345	25,310	26,150
<b>EBITDA</b>	32,839	8,519	6,857	7,722	2,958	935	1,332	424	945
<b>NON-CURRENT RESULTS</b>	(4,067)	(7,802)	(7,518)	(7,931)	(20)	(1,005)	(566)	2,235	(2,256)
<b>NET PROFIT</b>	(26,869)	(84,707)	107,477	5,460	(23,386)	19	824	2,688	(1,432)
<b>OPERATING CASH FLOW (OCF)</b>	7,208	9,425	9,825	11,912	3,219	3,260	1,721	730	1,236
<b>FREE CASH FLOW</b>	(12,736)	14,335	9,053	11,785	2,690	3,089	1,593	(691)	15
<b>RESERVES' BOOK VALUE</b>	321,091	235,750	343,337	348,590	322,727	348,590	322,727	355,903	355,903
<b>RESERVES' MARKET VALUE</b>	333,087	237,087	385,418	403,831	327,926	399,233	443,257	387,496	387,496
<b>TOTAL ASSETS</b>	350,867	270,790	387,783	404,310	381,729	406,915	383,279	414,385	415,231
<b>FINANCIAL DEBT</b>	360,013	359,676	359,539	359,583	359,632	359,583	359,632	359,670	359,714
<b>NET FINANCIAL DEBT*</b>	343,971	329,298	320,098	308,357	305,716	305,100	303,945	307,761	307,790
<b>RESERVES' MARKET VALUE / FINANCIAL DEBT</b>	0.93	0.66	1.07	1.12	0.91	1.11	1.23	1.08	1.08
<b>RESERVES' MARKET VALUE / NET FINANCIAL DEBT</b>	0.97	0.72	1.20	1.31	1.07	1.31	1.46	1.26	1.26
<b>Equity / Assets (%)</b>	(4.7%)	(34.4%)	5.6%	8.7%	4.3%	8.9%	4.6%	12.1%	12.3%
<b>NET GEARING (Net Debt to Equity) (x)</b>	(21.0)	(3.5)	14.7	8.8	18.8	8.4	17.2	6.1	6.0

**Notes:**

Figures rounded.

Accounts adjusted by ARC Ratings for analysis purposes.

2014 annual accounts audited by Caetano Pereira, António e José Reimão, S.R.O.C.. 2015 - 2017 period annual accounts audited by Moore Stephens & Associados, S.R.O.

2018 annual accounts audited by Vítor Almeida & Associados, S.R.O.C., S.A..

\*Financial debt net from cash and deposits and also from investments in debt securities issued by the Portuguese Government.

\*\*Assumed by oil operators, not ENSE.

**Sources:**

ENSE.

ENSE's revenues from the main activity corresponds to the recovery of its expenses on this activity from oil market operators, aiming to have a net profit in this activity tending to zero (except for gains or losses in the valuation or in the sale of reserves). Until now, expenses with the other activities (much lower) needs to be covered by these activities' revenues.

ENSE's financial statements are impacted by the oil price volatility in the book value of its oil reserves. The minimum oil price reached at the end of 2018 led the company to record an impairment loss of EUR 26.1 million, given that its oil reserves were recorded by the lower of its market value or acquisition cost. Conversely, in 2017 the company recorded a reversal of impairment loss of EUR 5.3 million. In the context of positive financial result, mainly reflecting interest gains from the investments in debt securities issued by the Portuguese Government, and a non-current EUR 4.5 million of guarantees enforced, ENSE recorded a loss of EUR 23.4 million in 2018, mainly due to the impairment loss, which is crucial for the company's results. Therefore, in the framework of reversal of impairment loss, in 2017 ENSE presented net profit of EUR 5.5 million.

In the first quarter 2019, i.e. the first period with the new responsibilities of ENSE, the company showed EUR 0.8 million of net profit, in the context of no change on the book value of strategic reserves of oil products. The company only calculate the impairment of loss or the reversal of this impairment at end of December. Thus, the impact of the recovery of oil prices in the first quarter of 2019 not was reflected in the financial statements, as usual.

ENSE's equity dropped to EUR 16.3 million at the end of 2018 mainly due to the loss in 2018, in part offset by the increase of the provision fund (by EUR 4.5 million). At the end of March 2019, the company's equity increased to EUR 17.7 million, benefiting from its net profit and the increase of the provision fund, by EUR 0.6 million. The provision fund increased to EUR 42.1 million at the end of March 2019 and corresponded to 11.2% of reserves' acquisition cost, being totally covered (122.6%) by a portfolio of debt securities.

At the end of March 2019, ENSE's borrowed funds correspond to the book value of the EUR 360 million bond being rated and that matures in 2028. This loan was contracted to finance the investment in oil reserves and, thus, the respective interest costs are recovered from oil market operators. The coverage of financial debt by reserves decreased to 0.91 times at the end of 2018 and improved to 1.23 times at the end of March 2019. The coverage of net financial debt by reserves is still above 1 times (1.07 times) at the end of 2018 and increased to 1.46 times at the end of March 2019.

In December 2018 ENSE prepared its updated 2019 forecasts and its 2020/2021 forecasts according to its current roles. ENSE updated its 2019 forecasts based on its 2018 estimates. Given the proximity of the end of the year, ENSE, exceptionally, considered the book value of the oil reserves taking into account the oil prices at 23 November 2018, which led to the estimate of a reversal of the impairment of loss of EUR 7.3 million in 2018 and to a book value of oil reserves of EUR 355.9 million (EUR 31.6 million below its market value as at 23 November 2018).

Regarding the main activity, ENSE assumed the maintenance of the 2018 estimate value of inventories (EUR 355.9 million) at the end of 2019 (as well as at the end of 2020). Thus, without including any impact from changes in the market value of oil reserves, considering no significant interest costs and increase of EUR 2.3 million in 2019 and in 2020 in the provision fund, ENSE estimates a net profit close to nil for its main activity in 2019 (as provided by law). From the monitoring activity of all energy sectors ENSE estimates a net profit of EUR 2.7 million in 2019. For this net profit determination point in time there was a EUR 4.5 million gain related to guarantees enforced. Without this gain this activity would present a loss of EUR 1.8 million.

For 2020, ENSE expect a global loss of EUR 1.4 million. This expected loss will come from the monitoring activity of all energy sectors. The company assumes that the potential loss from this activity will be financed by the Portuguese Government in the future, to the extent the expected revenues do not cover all operational costs. ARC Ratings continues to assume this assumption, as ENSE is a "State corporate entity" with the Portuguese Government its sole shareholder and ultimately responsible for its liabilities.

World Bank expected that average crude oil prices evolve to \$66/bbl in 2019 (a modest decrease compared with \$68/bbl in 2018) and to \$65/bbl in 2020, with balanced risks primarily related to policy outcomes.

ENSE plans to invest EUR 4.6 million in the POL NATO infrastructure over the 2019 – 2021 period (in an annual amount between EUR 1-2 million), to improve their operating conditions and ensuring compliance with the industry's most stringent safety, monitoring and operation standards. In addition, it should be highlighted the investment to be made in the IT area in an amount of EUR 1.3 million in the 2019-2020 period. These investments are planned to be financed by cash and deposits and short-term investments in debt securities issued by the Portuguese Government.

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