CORPORATE RATING REPORT - REVIEW

ENTIDADE NACIONAL PARA O SETOR ENERGÉTICO, E.P.E.

ARC Ratings affirms the final long-term issue public rating assigned to the EUR 360.0 million bond issued by Entidade Nacional para o Setor Energético, E.P.E. (ENSE).

4 October 2024

Issuer	Issue	Amount	Rating Class	Rating	Outlook	Initial Rating Date	Last Review Date	Next Review Date
Entidade Nacional para o Setor Energético, E. P. E.	Bond Loan	EUR 360 million	Corporate Long-Term Issue	A-	Positive	2 June 2008	5 March 2024	6 October 2025

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OVERVIEW

Issuer Profile

After the '70s oil crisis, major consuming countries agreed to an obligation to maintain adequate oil reserves to mitigate the effects of potential future supply problems. The founding of 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., represented Portugal's assignment of the responsibility for maintaining all or part of their emergency oil reserves to a state entity. Therefore, ENSE, founded in 2004, is a State-owned entity with the following duties:

- To be the Portuguese central stockholding entity for acquiring and maintaining the strategic portion of national emergency reserves of oil and oil products (oil reserves).
- Supervision of all energy sectors.
- Manage and monitor the storage activities for crude oil and its derivatives throughout the national territory to guarantee the supply of crude oil and petroleum products, depending on consumption needs.

Additionally, the current context of conflict in Europe between Russia and Ukraine raised the need to implement a scheme of strategic reserves to be applied to natural gas in addition to the existing emergency reserves (owned and managed by the incumbent operator of the country's gas transport, storage, and regasification). According to the Decree-law nº 70/2022, from 14 October, ENSE's duties were also extended to be the Portuguese central stockholding entity for acquiring and maintaining the strategic portion of national reserves of natural gas. The decree-law attributed this duty to ENSE, but the full extent of the impact of this new duty in the company is still dependent on several more specific definitions, part of which (volume, types of consumption to be considered and phasing of acquisition of reserves) are expected to be defined by a particular ordinance from the Portuguese Government.

Meanwhile, the company is conducting internal research and implementing the necessary organisational measures where required. Note that, similar to the oil products reserve activity, it will be the market operator's responsibility to bear the costs related to the reserves, and this new duty and any associated responsibilities will be completely segregated from the company's current role in terms of oil reserves. ARC doesn't expect this new duty to have a material impact on ENSE in the short term and will monitor the evolution of its definition and implementation.

Rating Rationale

This action reflects the implied support of the Portuguese sovereign in the context of no material change of ENSE's financial structure, i.e. keeping a comfortable coverage of its net financial debt provided by the market value of its oil reserves. ARC Ratings will monitor the determinants of the assigned rating and the evolution of the definition of relevant aspects to implement the new duty in the natural gas field.

The rating was assigned by ARC Ratings, S.A. and endorsed by ARC Ratings (UK) Limited by Statutory Instrument 2019 nº 266 - The Credit Rating Agencies (Amendment etc.) (EU Exit).

KEY RATING DRIVERS:

- **Government ownership** – the Portuguese Government wholly owns ENSE's share capital, and the bonds being rated have a continual ownership clause regarding the maintenance of this sole ownership by the Portuguese Government. Consequently, its rating is linked to the rating of the Portuguese Republic, currently at A-/Positive. Note that there is no obligation of timely support. Still, as established in the company's bylaws, the Portuguese Government 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 level remains unchanged, comprising solely the bond issue rated at EUR 360.0 million, maturing in 2028. As structurally intended, ENSE's expenses (including bond interest) have been covered by revenues, mainly from the Portuguese oil market operators. ENSE's cash and cash equivalents and investments in Portuguese Government-issued debt securities decreased to EUR 68.6 million in June 2024 and increased the company's net financial debt; however, in the second half of 2024, the net debt is decreasing again as cash and cash equivalents increase.

- **Stable, long-term relationships with key customers** – The entity has developed strong, mutually beneficial relationships with the leading distributors of oil products in Portugal: Repsol, S.A. (Repsol), Galp Energia, SGPS, S.A. (Galp Energia), BP p.l.c. (BP), Prio Supply, S.A. (PRIO) and Compañía Española de Petróleos S.A. (CEPSA).

- **Oil price volatility and the coverage of the loan by oil reserves** – ENSE's strategic position in the Portuguese oil market, coupled with its operational focus, results in a substantial concentration of assets in oil and oil derivatives. Consequently, the company's financial performance (assessed from an accounting perspective) is susceptible to fluctuations in oil prices. The decrease in oil prices led to a reduction in the coverage of gross financial debt by reserves to 1.44x at the end of 2023 (from 1.65x at the end of 2022). The coverage of net financial debt by reserves also decreased to 1.80x at the end of 2023 (2.07x at the end of 2022). Conversely, the oil price recovery in 1H 2024 has driven the improvement of these coverage ratios to 1.63x and 2.0x (1.39x and 1.75x at the end of 1H 2023), respectively. In the long term, the oil price may be impacted by the slow energy transition trend towards energy sources with lower environmental impact.

- **Concentration of customer base** – The majority of ENSE's revenues (82.2% in FY2023 and 86.5% in 1H 2024) continues to be derived from five companies (reflecting the oil distribution market concentration in Portugal): Repsol (accounting for 23.4% of ENSE's 1H 2024 revenues, 20.4% in FY2023), Galp Energia (22.2%, 23.0%), BP (22.1%, 20.4%), PRIO (9.5%, 8.6%) and CEPSA (9.3%, 9.8%). However, ENSE maintains stable relationships with them, and there is no risk of losing customers. ARC Ratings notes that the three customers mentioned above carry investment-grade credit ratings (the other two are not rated).

KEY TIPPING POINTS

Positive Turning Points

Triggers for a potential rating upgrade come from an upgrade of the Portuguese Sovereign rating.

Negative Turning Points

Triggers that could prompt a rating downgrade or a deterioration of outlook include:

– A downgrade of the Portuguese Sovereign rating; or

– A significant long-standing decrease in the coverage of the net financial debt by the market value of its oil reserves.

SHAREHOLDERS AND GOVERNANCE

ENSE's share capital is wholly owned by the Portuguese government, a "State corporate entity" with administrative, financial, and patrimonial autonomy. A new Board of Directors was appointed in April 2023 for the 2023-2025 period. As of December 2023, the company had 49 employees (more four than in December 2022), including two members of the Board of Directors and three non-permanent members of the Supervisory Board.

Since its foundation, ENSE has been legally assigned the duty of being the Portuguese central stockholding entity in acquiring and maintaining the strategic portion of national emergency reserves of oil and petroleum products. The company is responsible for maintaining the required level of strategic reserves and a continuously updated record of emergency reserves containing the information necessary for its respective control.

National emergency reserves of oil and petroleum products comprise ninety days of the nation's average daily net imports of crude oil and oil products from the preceding year, and its acquisition and maintenance are an obligation of oil market operators, distributed according to each company's market share. The share of reserves to be held by ENSE (strategic reserves), in substitution of oil market operators, corresponds to "one-third of the reserves which the bound operators are obliged to maintain", i.e., 30 days of the nation's average daily net imports of crude oil and oil products from the preceding year.

As mentioned above, Decree Law 70/2022, effective 14 October, extended ENSE's duties to include being the Portuguese central stockholding entity for acquiring and maintaining the strategic portion of national natural gas reserves. However, the details of this new duty are still to be defined.

According to the terms of the law, the following continues to apply to ENSE:

- In the case of dissolution of the company, the State assumes any losses arising from the liquidation of assets, as well as the residual responsibilities.
- The expenses associated with the company's build-up and maintenance of strategic reserves are fully supported by market operators, who are obliged to build up emergency reserves.
- ENSE is obliged to create a provision fund (recorded in equity), funded in annual increments, aiming to achieve at least an amount corresponding to 25% of the oil reserves' acquisition cost. At the end of June 2024, the provision fund was equivalent to 16.3% of the oil reserves' acquisition cost. The company doesn't have a pre-established time to achieve the 25% goal and, therefore, has been reinforcing the fund, balancing the need to achieve this goal and the impact on the costs for oil market operators.
- In the case of an energy crisis or severe supply disruption, if ENSE sells strategic reserves of oil products in a situation where proceeds obtained are insufficient to cover the average acquisition cost of the product, less the amount resulting from the proportional use of the provision fund, the State assumes the corresponding loss by making an extraordinary contribution to the fund.

ENSE's 2023 consolidated accounts were audited without qualifications by Vitor Almeida & Associados, S.R.O.C., S.A..

On 30 September 2024, ARC Ratings conducted a meeting with ENSE's senior management as part of the analytical review process. The main themes of discussion were the quantities of oil products introduced for consumption in FY2023 and 1H 2024, the oil reserves and their composition, the impact of the increased interest rates, the accounts receivables, and the investments carried out and to be carried out.

INDUSTRY OUTLOOK

ENSE studies and market operators point to a possible stabilisation of the oil products introduced for consumption in Portugal in 2024, with only a slight margin for upward or downward fluctuations.

There is a correlation between reserves of crude oil and its products and oil products introduced for consumption. From the company's point of view, if the decreasing trend of oil products introduced for consumption in Portugal became structural, the reduction of the national emergency reserves of oil and petroleum products will be achieved firstly by the decrease in CSO Tickets (Compulsory Stockholding Obligation, regarding short-term contracts that the company buys in the market from European peers with excess of physical reserves) with no need to reduce the physical reserves up to 2030 (i.e. after the maturity of the bond loan being rated in 2028). The company benefits from a flexible model of reserves, combining a level of physical reserves owned by the company for the long term and CSO tickets for short-term needs.

BUSINESS MODEL

Primary Activity – Holding and managing reserves of Crude Oil and Oil Products

The company's primary business activity focuses on acquiring, managing, and monitoring the strategic portion of national emergency reserves of oil and petroleum products, serving as a Central Storage Entity.

In FY2023, in an economic growth context, with a 2.3% increase in the Portuguese Gross Domestic Product (GDP), the total volume of oil products introduced for consumption in Portugal increased by 6.2%, reaching 8.7 million tonnes (Mton), surpassing the pre-pandemic level by 3.7%. All oil product categories experienced growth, particularly the A category (gasoline) of 8.9%, followed by the B category (diesel and jet) of 6.2%, and the C category (fuel oil and liquefied petroleum gas) of 1.8%. In 1H 2024, there was some volatility compared with 1H 2023, with four of the six months presenting increases in opposite to the other months, which led to a slight 1.3% reduction of the total volume of oil products introduced for consumption in Portugal (although 3.8% above the pre-pandemic level). Year to date, August 2024, this trend remains but less significant (<-1.0%).

The volume of oil products introduced for consumption in Portugal remains similar to previous periods. The primary type, the B category, accounted for 78.6% of the total in FY2023 (the same as in FY2022) and 78.5% in 1H 2024 (78.7%). In these periods, the A category accounted for 13.7% (13.4%) and 14.1% (13.2%), while the C category decreased to 7.7% (8.0%) and 7.4% (8.1%), respectively.

As legally defined, the increase in the total volume of oil products introduced for consumption in Portugal in FY2023 only impacts the calculation of the required oil products emergency reserves level in the 2H 2024 and in the 1H 2025, and so on.

It should be noted that the conflict between Russia, Ukraine, and the Middle East has had no impact on the European regulation of crude oil and oil products reserves. Recently, Saudi Arabia has expressed a desire to increase its oil production, which provides additional comfort and there will be no need to use the national emergency reserves of oil and oil products in Portugal.

In this environment, the company's physical reserves remained unchanged in FY2023 and the elapsed period of 2024 and covered a large part of the needs. The calculations of required emergency reserves are usually done at the end of the year, but the company keeps track of their progress throughout the year. Thus, the analysis of ENSE's physical reserves is reported at the end of FY2023.

ENSE's own physical reserves were at 0.94 Mton in FY2023, while its reserves under CSO Tickets increased to 0.5 Mton (from 0.2 Mton in FY2022) and 0.7 Mton in 1H 2024. This increase in CSO Tickets was related to the expansion of the emergency reserves of crude oil and oil products because of the rise in the total volume of oil products introduced for consumption in Portugal in the post-pandemic context and because of some national storage limitations. Most of the CSO tickets are acquired to replace the obligation of oil market operators (namely small oil operators). The company strategically acquired CSO Tickets in advance as a proactive measure to mitigate the impact of typical price fluctuations.

A breakdown of the reserves held by the company in FY2023 reveals that:

- ENSE still has the most reserves in physical products, but its share of the total has decreased to 63.6% from 81.4% in FY2022. The remainder was contracted under CSO Tickets (that increased as abovementioned), mainly finished products,
- ENSE's owned physical reserves continue to be stored in Portugal, according to applicable regulation, while the 36.4% of reserves contracted under CSO tickets were stored outside Portugal (in European countries with highly reputed entities), and
- Finished products, without considering the CSO Tickets, accounted for 42.7% of the total stocks, same as in FY2022 (whilst the percentage considering the CSO Tickets increased to 60.3%, from 34.7%), thus in both cases above the one-third required by law. The percentage of finished products does not represent a concern in ARC's view because there is oil refining capacity installed in Portugal. Additionally, the company reports that most oil market operators' direct reserves are finished products.

The storage of ENSE's own reserves in Portugal continued to be principally carried out under agreements with:

- Galp Energia, primarily stored near Galp Energia's oil refineries in Sines (80.1% of total), in the South of Portugal, and Matosinhos (3.9%), near Porto in the North of Portugal, and
- the Portuguese Government for the POL NATO deposits near Lisbon (14.9%).

This company ensures the quality of oil reserves stored under the agreements with Galp Energia. At the same time, the Bureau Veritas—Oil & Petrochemicals Laboratory—monitors the quality of diesel reserves stored in POL NATO deposits.

Storage costs passed on to the oil market operators, are updated based on the previous year's inflation rate.

ENSE continues to analyse alternative storage options to lower the operational costs of storing crude oil and oil products and decrease reliance on Portuguese refining capacity. However, it always prioritises the safety and quality of products and conditions of use in case of need.

The annual utilisation fee paid for the POL NATO deposits can be reduced if ENSE spends the difference in managing and improving this infrastructure. Under this agreement, ENSE must make additional investments. No investment was carried out in FY2023 (while EUR 0.5 million was carried out in FY2022), in both periods substantially below the budget because of the late approval of the annual budget that did not allow to carry out the public procurement procedures to execute the planned investment to prepare the POL NATO deposits for the rotation of diesel. For FY2024 and the following years, most likely in FY2025, the company plans to invest EUR 4.8 million. The execution of these investments will allow significant improvements in the conditions of those strategic facilities, providing them with more significant operational, maintenance and mobilisation capacity. ENSE plans to finance these investments with its own funds (more than enough considering the strong liquidity position in 1H 2024) and aims to start this investment as soon as possible.

Figure 1
Key Clients

	% of Revenue FY23	Credit Rating
Petróleos de Portugal - Petrogal, S.A. (GALP)	22.96%	Unrated
BP PORTUGAL - Comércio Combustíveis e Lub., S.A.	20.42%	A+ / Stable
REPSOL PORTUGUESA, SA	20.41%	BBB+/stable
CEPSA PORTUGUESA PETRÓLEOS, S.A.	9.82%	BBB- / Stable
PRIO SUPPLY, S.A.	8.56%	Unrated
	82.2%	

The company's main customers in this business area comprise Portugal's main leading distributors of oil products. In FY2023, the five main customers accounted for 82.2% of its total turnover (79.3% in FY2022), as mentioned in the table above. The increase was due to the higher need to purchase CSO Tickets. Note that three of the leading company's clients, accounting for more than 50% of its turnover, are rated in the "A" to "BBB" bands, presenting moderate credit risk.

Other Activities - Control and Prevention (Supervision)

The company specialises in overseeing the energy sector and plays a proactive role in ensuring the compliance of operators and infrastructures within the national petroleum system, including biofuels, natural gas, the national electricity system, and electric mobility. This involves conducting nationwide inspections to verify adherence to relevant rules and regulations in force, to ensure transparency and competitiveness between the different stakeholders, and to secure the security of the energy supply.

CASH FLOW GENERATION CAPACITY

Revenue

ENSE's revenues increased by 50.5% in FY2023, to EUR 39.6 million, and by 58.0% in 1H 2024, to EUR 28.3 million. The company's revenue growth was driven mainly by its main activity, which accounted for 97.9% of total revenues in FY2023 and 95.1% in 1H 2024.

ENSE's revenues from its primary activity correspond to the recovery of its expenses on this activity (operating and financing expenses) from oil market operators. The amounts to be received monthly are calculated every year based on the expenses forecasted by ENSE to have a net profit in this activity close to zero (except for gains or losses in the valuation or the sale of reserves). Therefore, in FY2023 and 1H 2024, the high revenues year-on-year increase from its primary activity, of 49.7% and 56.1%, respectively, was driven by CSO ticket sales raised by the increase of emergency reserves following a recovery in total volumes of oil products introduced for consumption in Portugal, and by the higher value of expenses to be recovered (in response to the inflationary pressures and increased interest rates).

ENSE's other revenues come from its other duties and aim to cover its expenses. These revenues come from the issue of biofuel tickets (biofuel tickets are a mechanism to facilitate the control of compliance with the obligation to incorporate biofuels in fuels) and other fees. In FY2023, these revenues increased by 71.4% to EUR 1.9 million, while in the 1H 2024, they grew 3.9 times to EUR 1.4 million.

Profitability Margins

ENSE's operational expenses primarily include supplies & services and staff costs. Supplies and services expenses increased year-on-year by 48.2% in FY2023 to EUR 28.2 million and by 51.3% to EUR 18.6 million, mainly driven by the subcontractors' costs related to the acquisition of CSO Tickets. These costs grew to EUR 8.7 million in FY2023 (EUR 0.6 million in FY2022) and reached EUR 7.6 million in 1H2024 (EUR 2.0 million in 1H 2023). In addition, due to high inflation, oil reserves storage costs increased by 7.3% in FY2023, to EUR 17.3 million, and by 3.9% in 1H 2024, to EUR 8.9 million. Staff costs rose because of salary adjustments and a small workforce reinforcement, by 15.4% in FY2023, to EUR 2.5 million, and by 26.9% in 1H 2024, to EUR 1.3 million.

Conversely, in FY2023, continuing a trend that began in 2019, there was no rotation of diesel stocks within the POL NATO infrastructure because of the infrastructure's existing operational constraints and the lack of investment to improve them. However, these diesel stocks still meet the quality requirements thanks to this infrastructure's excellent storage qualities.

The company's EBITDA increased year-on-year by 74.7% in FY2023 to EUR 8.8 million and 83.2% in 1H2024 to EUR 8.3 million. This increase reflects gains in CSO sales, which were EUR 4.1 million in FY2023 and EUR 8.9 million estimated for FY2024.

In FY2023 and 1H 2024, the impairment costs, net of reversal of impairment, to cover doubtful customers were immaterial (compared with EUR 0.8 million in FY2022 - small market operators).

The oil price volatility (an external factor) impacted ENSE's financial statements due to the book value of its reserves being recorded at the lower of its market value or the acquisition cost. In FY2023, a EUR 1.1 million impairment was recorded conversely to a EUR 0.4 million reversal of impairment in FY2022. Usually, ENSE only records an impairment loss or reversal of prior impairment losses in its inventories at the end of the year. However, in the 1H 2024, this impact would be a EUR 1.1 million reversal of impairment.

The provision fund remained unchanged during FY2023 and the 1H 2024, while in FY2022, it was reinforced by EUR 2.5 million with the company's free cash flow. In these periods, the company balanced the significant cost increases that the market operators have to accommodate, related to inflation, higher interest rates and acquisition of CSO tickets, with the already considerable level of the provision fund (EUR 60.9 million). ARC Ratings considers the provision fund credit positive and the costs of the provision fund as non-recurring, not affecting EBITDA and EBIT.

In FY2023, the company's net profit was EUR -5.3 million (EUR 0.2 million in FY2022), mainly driven by higher interest expenses and inflation than the forecasted and, therefore, not recovered from the market operators in this period. Conversely, in the 1H 2024, ENSE's net profit was EUR 1.8 million (EUR -0.5 million), benefiting from higher gains from the sale of CSO Tickets than forecasted and considered for the monthly recovery of costs from market operators.

Under Law 7-A/2016, ENSE's profits from managing strategic reserves of oil products have been exempt from corporate taxes since 2016.

The company's free cash flow became negative in FY2023 of EUR -0.7 million (compared with EUR 2.4 million in FY 2022). It worsened in 1H 2024 to EUR -4.7 million (EUR -0.3 million in 1H 2023) due to a significant interest paid increase in a high interest rate environment. The negative free cash flow is mitigated by good cash and cash equivalents and short-term investments in debt securities issued by the Portuguese Government. The company's projections indicate a return to positive free cash flow in FY2025.

Interest Costs and Coverage Ratios

The company's net interest expenses, mainly related to the bond loan, rose to EUR 12.2 million (66.5% above the budget) from EUR 1.2 million in FY2022 due to a high 6-month Euribor environment that started in mid-FY2022. EUR 7.3 million of interest expenses were recorded in 1H 2024 (EUR 4.8 million in 1H 2023). Note that the interest rate of ENSE's bond issuance is floored at 0% plus a spread of 0.12% until 7 August 2023 and 0.14% after that until the maturity and is not capped. Therefore, there is an interest rate risk. The average interest rate was 3.48% in FY2023. However, the interest costs of the bond are recovered from oil market operators; thus, ENSE does not assume this risk. The interest settlement dates are the beginning of February and August.

Interest gains from investments in debt securities issued by the Portuguese Government remained low in FY2023 but increased to EUR 0.9 million in 1H 2024.

The interest coverage and other associated bond costs paid by EBITDA reduced significantly to 1.2x in FY2023 (from 119.1x in FY2022) and 1.1x in the 1H 2024 (3.1x in 1H 2023). As mitigant, the company maintain significant cash and cash equivalents and short-term investments in debt securities issued by the Portuguese Government, which gives comfort in the context of an expected interest rate decreasing trend, but with uncertainty regarding the extension and time. On top of that, in line with its business model, ENSE will recover interest costs by charging market operators, thus passing the interest rate risk.

FINANCIAL POLICY

Balance Sheet Composition and Strength

ENSE's assets reached EUR 460.3 million in 1H 2024, slightly above the FY2023 figure, mainly due to increased accounts receivables. Current assets accounted for 99.6% of total assets in 1H 2024 (99.3% in FY2023).

Oil reserves are the ENSE's primary asset, recorded EUR 373.5 million in 1H 2024 (81.1% of total assets). The prevailing legal framework requires the reserves held by ENSE to be protected by suitable insurance. A multiple risks policy, including environmental risks, adequately covers oil products owned by ENSE and stored in the POL NATO deposits. The insurance coverage of oil products owned by ENSE that are stored with Galp Energia is contracted by Galp Energia, and the respective cost is included in the storage costs paid by ENSE.

ENSE also maintains insurance policies covering its exploration civil liability and environmental liability. Fidelidade—Companhia de Seguros, S.A., which is rated A+ (Insurer Financial Strength) and A (Long-Term Issuer Default Rating), has Stable outlooks, provided the entirety of these insurance policies.

The total amount of cash and cash equivalents and short-term investments in debt securities issued by the Portuguese Government decreased to EUR 68.6 million in 1H 2024, from EUR 73.3 million in FY2023 (EUR 73.9 million in FY2022), being ENSE's second most significant asset. EUR 60.9 million was for the coverage of the provision fund managed by the company, whilst the remaining EUR 7.7 million can be used freely, such as for funding investments related to the company's current duties.

Accounts receivables increased in 1H 2024, to EUR 6.3 million, from EUR 2.4 million in FY2023, due to some recovery agreements with previous doubtful customers, however it is expected to decrease in FY2024.

In FY2023 and 1H 2024, the company made EUR 0.1 million in investments (a decrease compared with EUR 0.7 million in FY2022), which was impacted by a lack of investment in the POL NATO infrastructure.

Leverage Ratios and Capital Structure

ENSE's equity decreased to EUR 80.2 million in FY2023 (from EUR 85.5 million in FY2022) and modestly increased to EUR 82.0 million in 1H 2024, impacted by the net profit. The equity/assets ratio of ENSE somewhat decreased to 17.8% in 1H2024 from 18.8% in FY2022.

ENSE's debt level remains unchanged, comprising solely the bond issuance that is rated in an amount of EUR 360 million, maturing 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.

ENSE's net financial debt increased in FY2023 and 1H 2024 to EUR 297.0 million in the latest period due to reduced cash and cash equivalents and investments in debt securities issued by the Portuguese Government, driven by negative free cash flow.

The company's net financial debt/EBITDA ratio is high but shows an improvement in FY2023 and 1H 2024, to 33.3x and 17.8x, respectively (57.1x in FY 2022). However, according to the ENSE's business model, which establishes nil net profit in its main business area, the leading indicator of its debt coverage is the coverage by reserves' market value. The oil price volatility significantly impacted ENSE's reserves' market value and the coverage of debt and net financial debt by reserves. Therefore, according to information provided by the company, the coverage of its gross debt by reserves declined to 1.44x in FY2023, from 1.65x in FY2022, and improved to 1.63x in 1H 2024. The company's net financial debt coverage by reserves presented the same trend, 1.80x in FY2023 (2.07x) and 2.01x in 1H 2024.

To provide additional insight and enable helpful comparison, the coverage ratios (financial debt by reserves) of two of ENSE's European peers, which have the same central strategic role and robust control from States, were also evaluated:

- The Spanish entity - Corporación de Reservas Estratégicas de Productos Petrolíferos (CORES) – which manages Spanish strategic oil reserves of petroleum products and assures oil and gas market had a coverage ratio of 2.98x at the end of 2023 (same for the net financial debt), that decreased from 3.37x at the end of 2023 (3.43x for the net financial debt). CORES rated A-/Stable (the same level assigned to the sovereign).
- The French entity - Société Anonyme de Gestion de Stocks de Sécurité (SAGESS) – established on the initiative of oil French operators and under the aegis of public authorities with the purpose of building up and stockpiling strategic oil reserves deteriorated the coverage ratio to 1.94x (2.07x for the net financial debt) from 2.34x at the end of 2023 (same for the net financial debt). SAGESS is rated AA-/Stable (the same level assigned to the sovereign).

Liquidity

Considering the bond's long-term maturity (bullet, due on 6 August 2028) and the significant value of cash and cash equivalents and short-term investments, ENSE's liquidity risk is still virtually nil. The company presents comfortable asset test ratios, and the bond's interest costs are recovered from oil market operators. Given the comfortable position of cash and cash equivalents and short-term investments, the company has no undrawn facilities, using its own short-term resources when needed.

FORECASTS

ENSE's FY2024 budget, prepared in March 2024, based on the FY2023 estimates, and approved in June 2024, is guiding the company's activity.

For FY2024, the company forecasted a significant increase in revenues to EUR 59.1 million (EUR 28.3m already recorded in 1H 2024), mainly from its primary activity, to recover the increase of operational costs, namely from the projected rise of CSO Tickets acquisition on demand of market operators and update storage costs, and financial costs (to EUR 13.5 million). The company budgeted a net profit close to nil, without impairment in oil reserves, as defined for its main activity. If a positive net profit remains, as occurred in the 1H 2024 (EUR 1.8 million), the company will reinforce the provision fund, as happened in the past, despite not being forecasted.

For FY2024, ENSE forecasts a slight net debt increase due to a projected decrease in cash and cash equivalents and short-term investments driven by negative free cash flow (EUR 8.1 million). Although EUR 6.3 million (mainly in POL NATO infrastructure) of capex is forecasted and likely will be lower, then with a positive impact on cash and cash equivalents and short-term investments. Therefore, the projected net debt/EBITDA ratio improvement to 21.4x, from 33.3x in FY2023, could be higher.

ENSE's 2025 budget is still in preparation and, therefore, is unavailable to incorporate in the current review report. Still, the general principles that underlie this budget are the same as those of previous budgets: to achieve the equilibrium between income and costs in its activities (without considering the impact of any change in the book value of its reserves).

It is important to note that ENSE's net profit and the company's net financial debt coverage by the market value of its reserves depends on two critical external factors: oil price and the EUR/USD exchange rate.

According to the World Bank Commodities Price Data, the average oil price (Brent crude), after registering a 17.2% reduction in 2023 to 82.6 USD/bbl, presented some recovery trend in 1H 2024. However, in Q3 2024, the monthly average showed a decreasing trend.

According to the U.S. Energy Information Administration (EIA), despite a drop in the Brent spot price in the beginning of September 2024, it is expected that ongoing withdrawals from global oil inventories stemming from OPEC+ production cuts will push the price back into the 80 – 90 USD/bbl range relatively quickly. Thus, it is estimated a small increase of Brent crude oil spot price to 83 USD/bbl in 2024 (from 82 USD/bbl in 2024) and to 84 USD/bbl in 2025.

The EUR/USD exchange rate continued to show some fluctuations, but it recovered in Q3 2024 (to 1.12 on 24 August 2024 and 1.11 on 1 October 2024, compared with 1.1 on 31 December 2023).

While not expected in the short-term, the possible significant unfavourable evolution of the market value of reserves in euros would have a negative accounting impact on the company's equity and related ratios but no impact on its cash flow, given that it does not trade in oil products. Although trading in oil products is not part of the company's activities, oil reserves may need to be partially sold to respond to any strategic need or, in the long term, due to lower consumption of oil products due to the energy transition trend. Above all, ENSE's credit quality is mainly dependent on the Portuguese Government's credit quality, given its sole ownership of ENSE and its ultimate responsibility for ENSE's liabilities defined by law, as well as the strategic goal the company has in the Portuguese oil market, a role assigned by the government. However, it should be noted that no formal guarantee is in place.

As mentioned before, the extension of ENSE's duties to the natural gas strategic reserves will follow a similar business model to the oil products strategic reserves activity (the market operators will bear the costs). However, there are still several relevant aspects that need to be defined. Therefore, ARC doesn't expect this new duty to have a material impact on ENSE in the short term. The evolution of the definition of these aspects and the implementation of this new duty will be closely monitored by ARC.

ISSUANCE CONDITIONALITY

The rating assigned applies specifically to the EUR 360.0 million bond issued by ENSE (under its previous name of EGREP - Entidade Gestora de Reservas Estratégicas de Produtos Petrolíferos, E.P.E.) on 6 August 2008, with these main terms:

- A 20-year maturity with full repayment of principal at maturity, which will occur on 6 August 2028.
- Variable interest rate at EURIBOR 6 months + 0.12% until 7 August 2023. This spread slightly increased to 0.14% until the maturity.
- The possibility of full but not partial early redemption at the issuer's initiative, on 7 August 2023 (option not taken), or: "in the event, the following circumstances occur cumulatively:
    - change, after the issue date, of tax regulations applicable in Portugal, or change in the official application or interpretation of such regulations that impose upon the issuer the obligation to pay additional sums other than foreseen in the contractual documentation.
    - the issuer cannot avoid the referred imposition by taking measures available to it for the purpose, within reasonable criteria".
- Early redemption, among others, in the following cases:
    - if the Portuguese Government ceases to hold, directly or indirectly, the entire share capital and voting rights of the issuer, or if the issuer ceases to have the legal status of an "entidade pública empresarial" (State corporate entity);
    - if any change in the issuer's legal framework eliminates or restricts the Portuguese Government's current obligation to assume losses arising from the liquidation of assets, as well as any residual responsibilities;
    - non-performance of pari passu and/or negative pledge clauses;
    - change in the 0% weighting attributed by the Bank of Portugal to the liabilities of credit institutions to the issuer for the purpose of calculating the solvency ratio and the limits to major exposures.

APPENDIX 1 - FINANCIAL DATA AND RATIOS

ENSE- CONSOLIDATED FINANCIALS AND RATIOS (THOUSAND EUROS)

		FYE Dec 2020	FYE Dec 2021	FYE Dec 2022	FYE Dec 2023	1H 2023	1H 2024	FYE Dec 2024 (F)
Key Parameters - Income & Cash Flow	Revenue	28,514	27,064	26,278	39,554	17,889	28,262	59,126
	EBITDA	6,352	6,682	5,024	8,778	4,553	8,342	13,928
	EBIT	(69,894)	86,710	3,816	6,961	4,361	8,177	13,526
	Net Financing Cost	(276)	35	1,191	12,247	4,844	6,422	13,509
	Non-Recurring Costs	5,639	6,543	2,453	0	0	0	0
	Net Profit	(75,272)	80,115	162	(5,295)	(483)	1,754	17
	Fund Flow From Operations	6,453	90,888	9,720	(3,230)	(1,886)	647	12,825
	Free Cash Flow	6,310	6,271	2,390	(668)	(300)	(4,680)	(8,140)
Margins	EBITDA margin	22.3%	24.7%	19.1%	22.2%	25.5%	29.5%	23.6%
	EBIT margin	(245.1%)	320.4%	14.5%	17.6%	24.4%	28.9%	22.9%
	FCF margin	22.1%	23.2%	9.1%	(1.7%)	(1.7%)	(16.6%)	(13.8%)
	FFO margin	22.6%	335.8%	37.0%	(8.2%)	(10.5%)	2.3%	21.7%
Interest Coverage	FFO Interest Coverage	156.2	2,156.2	231.1	0.5	(0.3)	1.1	1.9
	EBITDA/Interest Paid	152.8	158.5	119.1	1.2	3.1	1.1	1.0
Key Parameters - Balance Sheet	Reserves's Book Value	293,137	374,288	374,646	373,493	374,646	373,493	374,646
	Reserves's Market Value	293,310	492,555	594,228	525,046	507,897	596,829	n.av.
	Total Assets	362,651	450,463	454,396	456,391	460,402	460,346 -	457,079
	Gross Financial Debt	359,716	359,758	360,981	365,755	364,357	365,587	364,621
	Net Financial Debt	294,358	288,172	287,035	292,474	290,708	296,987	298,123
Leverage	Reserves's Market Value /Gross Financial Debt	0.82	1.37	1.65	1.44	1.39	1.63	n.av.
	Reserves's Market Value /Net Financial Debt	1.00	1.71	2.07	1.80	1.75	2.01	n.av.
	Total Gross Financial Debt/EBITDA	56.6	53.8	71.9	41.7	40.0	21.9	26.2
	Total Net Financial Debt/EBITDA	46.3	43.1	57.1	33.3	31.9	17.8	21.4
	FFO Leverage	55.4	4.0	37.0	92.3	(440.5)	22.6	13.3
	Current Ratio (x)	53.7	57.6	52.4	29.1	30.5	25.9	32.5
	Acid Test (x)	10.1	9.5	9.0	5.1	5.5	4.8	5.4
	Equity / Assets (%)	(1.0)	18.4	18.8	17.6	18.5	17.8	18.1

Notes:
Figures rounded.
F = Forecasts.   n.av. = Non available.
Accounts adjusted by ARC Ratings for analysis purposes.
2020 to 2023 Accounts certified by Vitor Almeida & Associados, S.R.O.C., S.A.. Interim periods unaudited figures.

Sources:
ENSE's Annual Reports and additional information. ENSE's Budget for 2024 prepared in March 2024.

RELATED CRITERIA AND RESEARCH

ARC Ratings' Non-Financial Corporate Entities Rating Methodology.

Entidade Nacional para o Setor Energético, E. P. E. Initial Rating Report (2 June 2008).

Entidade Nacional para o Setor Energético, E. P. E. Previous Rating Report (13 September 2023).

PERIOD OF ANALYSIS AND MATERIALS USED IN RATING PROCESS

Period of Analysis

Historic: 2020 to 1H 2024.

Forecast: 2024.

Materials Used in the Rating Process

Entidade Nacional para o Setor Energético, E.P.E. Annual Reports and Audited Accounts – 2020 to 2023.

Entidade Nacional para o Setor Energético, E.P.E. Interim Unaudited Accounts

Entidade Nacional para o Setor Energético, E.P.E. 2024 Forecasts

Details on Entidade Nacional para o Setor Energético, E.P.E.'s Reserves

World Bank's Commodity Markets Outlook.

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