ARC Ratings affirms ENMC's "BB+" rating, and change the outlook to Stable, from Negative

ISSUER

ENMC - Entidade Nacional para o Mercado de Combustíveis, E.P.E.

ISSUE RATING

BB+ Medium and Long Term (BB+, with stable outlook)

RATING DATE

7 September 2017

ARC Ratings, S.A. (ARC Ratings) has affirmed the "BB+" rating accorded to the EUR 360.0 million bond loan issued by ENMC - Entidade Nacional para o Mercado de Combustíveis, E.P.E. (ENMC), on 6 August 2008. ARC Ratings also changed the rating outlook to stable, from negative, driven by the recovery in oil prices, that is expected to be sustainable according to consensus forecasts, and, consequently, the recovery of the coverage of financial debt by the oil products reserves at market value, and increase of investments in debt securities issued by the Portuguese Government. In addition, ARC assumes that, in the under-study reorganization of public entities with responsibilities in the energy sector in Portugal, ENMC will maintain its main duty of being the Portuguese central stockholding entity in the constitution and maintenance of the strategic portion of national emergency reserves of oil and oil products and, as a consequence of this role, should also remain a "State corporate entity".

COMPANY PROFILE

ENMC, founded in 2001 and headquartered in Portugal, is a State-owned entity and was assigned by law with the duty of being the Portuguese central stockholding entity in the constitution and maintenance of the strategic portion of national emergency reserves of oil and oil products. Additional responsibilities include the supervision of the National Petroleum System, monitoring the markets for crude oil, oil products, liquefied petroleum gas, biofuels, promotion of technical safety and fuel quality, as well as prospection, research, development and exploitation of oil resources. In 2017 ENMC's reorganization process with all its new duties was concluded. This process also involved changes in the Board of Directors of the company, which occurred in December 2016.

RATING RATIONALE

The key rating drivers for ENMC's bond loan rating are:

- Government ownership – ENMC's share capital is wholly owned by the Portuguese Government. Consequently, its rating is indirectly linked to the ratings of the Portuguese Republic (BBB- / Stable / A-3), however there is no obligation of timely support, but the Portuguese Government is ultimately responsible for ENMC's liabilities, as is established in law ("in the case of dissolution of ENMC, the State assumes any losses arising from the liquidation of assets, as well as the residual responsibilities").
- Financial stability and favourable debt profile – In 2016, as a result of the recovery of oil prices, the impairment in

inventories was reversed with positive impact on the company's equity (which became positive). Above all, ENMC's expenses (including bond loan interests) have been totally covered by revenues, mainly originated from the oil market operators. In addition, the entity's debt levels remain largely unchanged, still comprising the bond loan that is rated in an amount of EUR 360 million, maturing in 2028, the investments in Portuguese Government issued debt securities increased and the cash position remained positive.

- 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 ENMC's bond loan rating are:

- Oil price volatility and the coverage of loan by reserves – The nature of ENMC's operations and concentration of its assets render its financial performance heavily exposed to oil price fluctuations. However, the coverage of financial debt by reserves recovered to 1.07 times at the end of 2016 (from 0.66 times at the end of 2015) and remained above 1.0 times as at 24th April 2017. Given the significant amount of investments in debt securities issued by the Portuguese Government and cash and deposits held by ENMC, the coverage of net financial debt by reserves increased to 1.20 times at the end of 2016.
- Concentration of customer base – The majority of ENMC's revenue continues to be derived from just four companies: Repsol (that represented 27% of ENMC's revenues in 2016), Galp Energia (24%), BP and CEPSA (16% each).

RECENT DEVELOPMENTS AND OUTLOOK

In 2016, the total volume of oil products introduced for consumption in Portugal increased 1.5%, to 7.8 million tonnes, compared with a 2.6% increase in 2015 and a stabilization in 2014. Increases in the B (diesel) and C (fuel oil) categories continued to compensate decreases registered in A (gasoline) and D (liquefied petroleum gases – LPG) categories. The volume mix of oil products introduced for consumption in Portugal did not change, with the B category representing more than three quarters and the A around 14%. The required national emergency reserves (90 days) and ENMC's strategic reserves (30 days) increased 1.2% in 2016, in aggregate, to 1 928.2 thousand tonnes (tton) and 642.7 tton, respectively.

In 2016, ENMC increased its reserves contracted under CSO Tickets (Compulsory Stockholding Obligation) to 249 tton at the end of 2016, while its own reserves stabilized at 938 tton. Thus, ENMC still maintained at that date a substantial headroom between its own reserves and the legally required strategic reserves (642.7 tton), with significant headroom in all categories, allowing ENMC to continue replacing part of the operators' own obligation.

At the end of 2016, the totality of ENMC's reserves were stored in Portugal under agreements with Galp Energia and with the Portuguese Government (for the POL NATO deposits near Lisbon). ENMC is studying the possibility of future storage in caverns in Portugal, which presents some advantages due to their underground location. At that date, finished products represented 42.1% of the total stocks (compared with one third required by law).

ENMC's financial performance in 2016 was positively affected by the reversal of a significant part of the impairment losses recorded in the previous years. The 2016 reversal of impairment loss amounted to EUR 107.6 million. Thus, ENMC recorded a net profit of EUR 107.5 million in 2016.

ENMC - FINANCIALS AND RATIOS (THOUSAND EUROS)

	2012	2013	2014	2015	2016	2016 Jan to Mar	2017 Jan to Mar	2017 (F)	2018 (F)
TURNOVER	37,922	219,427	79,747	24,562	24,331	8,154	6,645	25,455	25,504
EBITDA	16,240	126,816	32,839	8,519	6,857	4,240	2,541	6,375	4,324
NET PROFIT	27	(11,894)	(26,869)	(84,707)	107,477	18,128	1,730	2,048	(497)
OPERATING CASH FLOW (OCF)	13,495	127,852	7,208	9,425	9,825	4,039	n.av.	8,101	3,538
FREE CASH FLOW	972	(4,063)	(12,736)	14,335	9,053	3,452	n.av.	6,814	2,031
RESERVES' BOOK VALUE	349,601	279,692	321,091	235,750	343,337	251,401	343,337	343,338	343,338
RESERVES' MARKET VALUE	725,834	505,098	333,087	237,087	385,418	251,401	355,035	385,418	385,418
TOTAL ASSETS	390,912	387,140	350,867	270,790	387,783	290,053	394,632	396,162	399,243
FINANCIAL DEBT	366,567	360,019	360,013	359,676	359,539	359,504	359,539	359,539	359,539
NET FINANCIAL DEBT*	333,689	331,239	343,971	329,298	320,098	326,047	314,766	313,113	311,253
RESERVES' MARKET VALUE / FINANCIAL DEBT	1.98	1.40	0.93	0.66	1.07	0.70	0.99	1.07	1.07
RESERVES' MARKET VALUE / NET FINANCIAL DEBT	2.18	1.52	0.97	0.72	1.20	0.77	1.13	1.23	1.24
Equity / Assets (%)	5.4%	2.7%	(4.7%)	(34.4%)	5.6%	(25.3%)	6.2%	7.0%	7.8%
NET GEARING (Net Debt to Equity) (x)	15.9	31.5	(21.0)	(3.5)	14.7	(4.4)	12.9	11.3	10.0

Notes:
Figures rounded.
Accounts adjusted by ARC Ratings for analisys purposes.
Annual accounts audited by Caiano Pereira, António e José Reimão, S.R.O.C.. in 2012 - 2014 period and by Moore Stephens & Associados, S.R.O.C..in 2015.
****Financial debt net from cash and deposits and also from investments in debt securities issued by the Portuguese Government.***

Sources:
ENMC.

In 2016 ENMC registered an increase in operational expenses due to the new duties in the supervision of the National Petroleum System. However, these expenses were lower than those forecasted. Interest costs stood at EUR 0.1 million in 2016 (compared with EUR 0.7 million in 2015) due to the downward trend of 6-months Euribor. In these conditions, the interest costs were more than compensated by interest gains, from the investments in debt securities issued by the Portuguese Government. Thus, the coverage of interest costs by EBITDA increased to 80.3 times in 2016, from 11.6 times in 2015. Benefiting in a favourable context, in 2016 ENMC made an extraordinary increase in the provision fund in the amount of EUR 7.5 million.

ENMC's equity returned to a positive value at the end of 2016, EUR 21.8 million. The provision fund, included in equity, increased to EUR 29.1 million at the end of 2016 and to EUR 30.1 million at the end of March 2017 (corresponding to 8.0% of reserves' acquisition cost). At that date, the provision fund was totally covered (114.5%) by a portfolio of debt securities issued by the Portuguese Government.

At the end of March 2017, ENMC's borrowed funds continued to be almost entirely related with its financial debt (EUR 359.5 million), corresponding to the book value of the EUR 360 million bond loan being rated and that matures in 2028. The coverage of financial debt by the market value of oil reserves owned by ENMC recovered to 1.07 times at the end of 2016 (and still above one times on 24th April 2017) from 0.66 times at the end of 2015.

ENMC prepared its 2018 forecasts based on its 2017 estimates (which already incorporate real data for the first half and an extrapolation until the end of the year). Regarding the main activity, ENMC assumed the maintenance of the 2016 value of inventories (EUR 343.3 million) at the end of 2017 and at the end of 2018. Thus, without including any impact from changes in the market value of oil reserves, considering increases in the provision fund respectively of EUR 3.9 million and of EUR 4.0 million, and that the activity of monitoring the petroleum products market will continue to generate no revenue, ENMC estimates a net profit of EUR 2.0 million in 2017 and EUR -0.5 million in 2018.

The assumptions made by the company lead to improvements in the equity / assets ratio, to 7.8%, and in the net gearing ratio, to 10.0 times, at the end of 2018. The coverage of net financial debt by reserves (at market value) will slightly increase, to 1.24 times, through the reduction of the net debt.

ENMC plans to invest EUR 16.8 million in the POL NATO infrastructure over the 2017 – 2020 period (in an annual amount lower than EUR 1.5 million from 2017 to 2019 and around EUR 13 million in 2020). This investment is planned to be financed by cash and deposits and short-term investments in debt securities issued by the Portuguese Government.

THIS DISCLOSURE IS FOR INFORMATION PURPOSES ONLY AND SHOULD BE READ IN CONJUNCTION WITH THE RESPECTIVE RATING REPORT.

ARC Ratings, S.A.

Rua de São José, 35 – 1° B
1150-321 Lisbon
PORTUGAL
Tel: +351 213 041 110
Fax: +351 213 041 111
E-mail: arcratings@arcratings.com
Site: www.arcratings.com

Key Contacts:

Isabel Fernandes
Lead Analyst
+351 213 041 110
E-mail: isabel.fernandes@arcratings.com

Emma-Jane Fulcher
Panel Chairperson / CRO
+44 (0)1622 684548
E-mail: emma.fulcher@arcratings.com

Registered as a Credit Rating Agency by the European Securities and Markets Authority (ESMA), within the scope of the REGULATION (EC) N° 1060/2009 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL, of 16 September, and recognised as External Credit Assessment Institution (ECAI).

Ratings do not constitute a recommendation to buy or sell, but only one of the factors to be weighted by investors.

Ratings are assigned based on information, including confidential information, collected from a wide group of sources, and in particular from the entity whose financial commitments are subject to rating. ARC Ratings uses and treats this information with due care and attention. Although all due care was taken in the collection, cross-checking and processing of the information for the purposes of the rating analysis, ARC Ratings cannot be held liable for its truthfulness. ARC Ratings must make sure that the information has a minimum level of quality prior to assigning a rating based on such information.