

# ARC Ratings affirms ENSE's "BB+" rating, and change the outlook to Positive, from Stable

## ISSUER

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

## ISSUE RATING

**BB+**

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

## RATING DATE

7 September 2018

**A**RC Ratings, S.A. (ARC Ratings) has affirmed the "BB+" rating accorded to the EUR 360.0 million bond loan issued by Entidade Nacional para o Setor Energético, E.P.E. (ENSE), on 6 August 2008. ARC Ratings also changed the rating outlook to positive, from stable, driven by the continuous 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 that allowed to improve the coverage of net financial debt by these reserves. In addition, being a "State corporate entity", ARC assumes that if the monitoring activity of all energy sector is not self-sustaining, ENSE will benefit from Portuguese Government financing, whose rating outlook assigned by ARC has also improved to positive, from stable, on 18 May 2018.

## COMPANY PROFILE

ENSE, formerly designated ENMC - Entidade Nacional para o Mercado de Combustíveis, E.P.E. and EGREP - Entidade Gestora de Reservas Estratégicas de Produtos Petrolíferos, E.P.E., founded in 2001 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 constitution and maintenance of the strategic portion of national emergency reserves of oil and oil products (its main activity).

Within the recent reorganization of public entities with responsibilities in the energy sector in Portugal, the company's duty of supervision was enlarged to all energy sector (including electricity and natural gas sectors). ENSE still managing and monitoring of the storage activities of crude oil and its derivatives throughout the national territory, in order to guarantee and ensure the conditions of supply of crude oil and petroleum products, depending on consumption needs.

## RATING RATIONALE

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

- Government ownership – ENSE's share capital is wholly owned by the Portuguese Government. Consequently, its rating is indirectly linked to the ratings of the Portuguese Republic (BBB- / Positive / A-3), however there is no obligation of timely support, but the Portuguese Government is ultimately responsible for ENSE's liabilities, as is established in law ("in the case of dissolution of ENSE, the State assumes any losses arising from the liquidation of

assets, as well as the residual responsibilities”).

- Financial improvement and favourable debt profile – In 2017, as a result of the recovery of oil prices, part of the impairment in inventories was reversed with positive impact on the company’s equity. Above all, ENSE’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 ENSE's bond loan 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. However, the coverage of financial debt by reserves slightly improved to 1.12 times at the end of 2017 (from 1.07 times at the end of 2016) and remained at that level at the end of March 2018. Given the significant amount of investments in debt securities issued by the Portuguese Government and cash and deposits held by ENSE, the coverage of net financial debt by reserves increased to 1.31 times at the end of 2017 and at the end of March 2018 (compared with 1.20 times at the end of 2016).
- Concentration of customer base – The majority of ENSE’s revenue continues to be derived from just four companies: Repsol (that represented 28% of ENSE’s revenues in 2017), Galp Energia (26%), BP (19%) and CEPSA (12%).

## **RECENT DEVELOPMENTS AND OUTLOOK**

The total volume of oil products introduced for consumption in Portugal increased 2.9% in 2017, to 8.1 million tonnes (Mton), compared with a 1.5% increase in 2016. Increases in the 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 close to 78% and the A category 13%, while the C and D categories accounting for 5% each. In the context of increase in the total volume of oil products introduced for consumption in Portugal, the required national’s emergency reserves (90 days) and ENSE’s strategic reserves (30 days) increased 3.2% in 2017, in aggregate, to 1 989.4 thousand tonnes (tton) and 663.1 tton, respectively.

ENSE increased its own reserves to 1 088.1 tton at the end of 2017, while its reserves contracted under CSO Tickets (Compulsory Stockholding Obligation) increased to 303.5 tton, from respectively 938 tton and 249 tton at the end of 2016. Therefore, ENSE reinforced the substantial headroom between its mentioned own reserves and the legally required strategic reserves (663.1 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 is 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 the possibility of future

storage in caverns in Portugal, which presents some advantages due to their underground location. At the end of 2017, finished products represented 44.3% of the total stocks (compared with one third required by law).

ENSE's financial performance in 2017 was positively affected by the reversal of part of the impairment losses recorded in the previous years. The 2017 reversal of impairment loss amounted to EUR 5.3 million (although less significant than EUR 107.6 million in 2016), as a result of the recovery of oil price in 2017. Thus, ENSE recorded a net profit of EUR 5.5 million (compared with EUR 107.5 million in 2016). Without the impact of the reversal of part of the impairment losses the Company's net profit would be slightly positive by EUR 0.2 million, mainly as a result of its remaining activities, despite the monitoring activity of the petroleum products still did not generate revenue.

#### ENSE - FINANCIALS AND RATIOS (THOUSAND EUROS)

	2013	2014	2015	2016	2017	2017 Jan to Mar	2018 Jan to Mar	2018 (F)	2019 (F)
<b>TURNOVER</b>	219,427	79,747	24,562	24,331	25,398	6,645	5,988	24,771	26,980
<b>EBITDA</b>	126,816	32,839	8,519	6,857	7,722	2,541	935	3,024	2,735
<b>NET PROFIT</b>	(11,894)	(26,869)	(84,707)	107,477	5,460	1,730	19	(697)	506
<b>OPERATING CASH FLOW (OCF)</b>	127,852	7,208	9,425	9,825	11,912	n.av.	3,260	2,876	1,115
<b>FREE CASH FLOW</b>	(4,063)	(12,736)	14,335	9,053	11,788	n.av.	3,089	2,568	(99)
<b>RESERVES' BOOK VALUE</b>	279,692	321,091	235,750	343,337	348,590	343,337	348,590	348,590	348,590
<b>RESERVES' MARKET VALUE</b>	505,098	333,087	237,087	385,418	403,831	355,035	399,233	403,831	403,831
<b>TOTAL ASSETS</b>	387,140	350,867	270,790	387,783	404,310	394,632	406,915	407,412	410,218
<b>FINANCIAL DEBT</b>	360,019	360,013	359,676	359,539	359,583	359,539	359,583	359,595	359,605
<b>NET FINANCIAL DEBT*</b>	331,239	343,971	329,298	320,098	308,357	314,766	305,100	305,801	305,911
<b>RESERVES' MARKET VALUE / FINANCIAL DEBT</b>	1.40	0.93	0.66	1.07	1.12	0.99	1.11	1.12	1.12
<b>RESERVES' MARKET VALUE / NET FINANCIAL DEBT</b>	1.52	0.97	0.72	1.20	1.31	1.13	1.31	1.32	1.32
<b>Equity / Assets (%)</b>	2.7%	(4.7%)	(34.4%)	5.6%	8.7%	6.2%	8.9%	9.4%	10.0%
<b>NET GEARING (Net Debt to Equity) (x)</b>	31.5	(21.0)	(3.5)	14.7	8.8	12.9	8.4	8.0	7.4

#### Notes:

Figures rounded.

Accounts adjusted by ARC Ratings for analysis purposes.

2013 to 2017 annual accounts audited by Moore Stephens & 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.

#### Sources:

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Interest costs, which are allocated to the activity of managing oil reserves (the financial debt was contracted to finance the acquisition of oil reserves), were not significant in 2017. In these conditions, the Company continued to present positive financial result, mainly reflecting interest gains from the investments in debt securities issued by the Portuguese Government. Thus, the coverage of interest costs by EBITDA increased to 206.3 times in 2017, compared with 80.3 times in 2016.

ENSE's equity was reinforced to EUR 35.1 million at the end of 2017 and to EUR 36.2 million at the end of March of 2018, from EUR 21.8 million at the end of 2016, mainly as a result of the positive net profit and the increase of the provision fund. The provision fund increased from EUR 29.1 million at the end of 2016 to EUR 37 million at the end of 2017 and to EUR 38.1 million at the end of March 2018 (corresponding to 10.1% of reserves' acquisition cost). At that date, the provision fund was totally covered (130.5%) by a portfolio of debt securities issued by the Portuguese Government.

At the end of March 2018, ENSE's borrowed funds continued to be almost entirely related with its financial debt (EUR 359.6 million), corresponding to the book value of the EUR 360 million bond loan being rated and that matures in 2028. As above-mentioned, 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 the market value of oil reserves owned by ENSE improved to 1.12 times at the end of 2017 (and stabilised at that level at the end of March 2018), from 1.07 times at the end of 2016. Considering the net financial debt, this coverage ratio improved to 1.31 times at the end of 2017 and at the end of March 2018, from 1.20 times at the end of 2016.

ENSE prepared its 2019 forecasts based on its 2018 estimates (which already incorporate real data for the first half and an extrapolation until the end of the year). ENSE's 2019 forecasts was prepared prior to the publication of the Decree-Law 69/2018, therefore considers the competencies attributed to the Company until the end of August 2018. Regarding the main activity, ENSE assumed the maintenance of the 2017 value of inventories (EUR 348.6 million) at the end of 2018 and at the end of 2019. Thus, without including any impact from changes in the market value of oil reserves, considering no significant interest costs and increases in the provision fund respectively of EUR 4 million and of EUR 2.3 million, ENSE estimates net profit of EUR 0.4 million in 2018 and of EUR 0.2 million in 2019. Globally, given that the activity of monitoring the petroleum products market still does not generate revenue, ENSE estimates a net profit of EUR -0.7 million in 2018 and of EUR 0.5 million in 2019.

The assumptions made by the Company lead to improvements in the equity / assets ratio, to 10%, and in the net gearing ratio, to 7.4 times, at the end of 2019. The coverage of net financial debt by reserves (at market value) will stabilise in 1.32 times, given that ENSE forecasts cash and deposits and investments in debt securities issued by the Portuguese Government of EUR 53.7 million at the end of 2019 (close to the level already reached at the end of March 2018).

It should be noted that, following the reorganization of public entities with responsibilities in the energy sector in Portugal, ENSE, keeping its forecasts for the main activity, will amend its global 2019 forecasts. Its main activity is self-sustaining by law. Although it is still to be defined, ARC assumes that if the monitoring activity of all energy sector is not self-sustaining, ENSE will benefit from Portuguese Government financing, its sole shareholder and ultimately responsible for its liabilities.

ENSE plans to invest EUR 5.6 million in the POL NATO infrastructure over the 2018 – 2021 period (in an annual amount between one million and two million of Euros), 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 held in the IT area in an amount of EUR 1.6 million in the 2018-2020 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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**THIS DISCLOSURE IS FOR INFORMATION PURPOSES ONLY AND SHOULD BE READ IN CONJUNCTION WITH THE RESPECTIVE RATING REPORT.**

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