



2016 ANNUAL  
AND CORPORATE  
RESPONSIBILITY REPORT

# RISK MAP

PERIOD 2017 - 2021

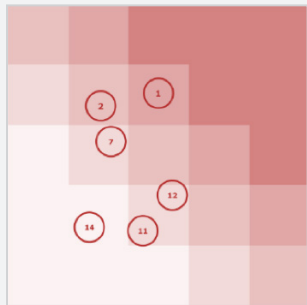


**CEPSA**



## STRATEGIC AND PLANNING RISKS

Related to Corporate Responsibility and Sustainability, external factors such as the economic situation, sectoral scope, country risk, regulation, competition and catastrophic natural events or damage caused by third parties, as well as those related to the strategic positioning of the company.



- 1. Refining margin
- 2. Production and replacement of reserves
- 7. Geopolitical risk
- 11. Market competition
- 12. Demand evolution
- 14. Relations with local communities

## EXTERNAL CONTEXT AND THREATS

- The price of crude oil remains low, although it is expected to slowly recover as supply and demand balance out.
- The world economy maintained moderate growth in 2016 and is expected to continue along this path in 2017, primarily relying on countries outside the OECD.
- In the geopolitical context, with the new Trump era, Brexit or the terrorist threat of the Islamic State, are presented as some of main uncertainties in the short term.
- In the current economic context where Cepsa produces and markets its products, noteworthy are the growth ratios of the Spanish economy (GDP, demand for oil-derivative products, etc.) and China has seemingly curbed the slowdown of its economy, where Shanghai plant activity in 2015 was launched against a backdrop of high and marked competition over market supply of phenol and acetone.
- Increased competition from U.S. and Middle East refineries, which, combined with a refinery overcapacity in Europe, is pushing the margin of this activity downward. The entry into force of the MARPOL regulation in 2020 is expected to result in a rise in margins.
- Localization or acquisition of reserves in countries that are politically, economically or legally unstable.
- Strong competitive environments due to the pressure of markets with greater production advantages (access to cheaper crude oil, fewer regulatory restrictions, etc.).

## RISKS

- Refining margin, conditioned by the context of installed overcapacity in Europe, the opening of new refineries in Asia and the Middle East and market volatility.
- Production and replacement of reserves.
- Geopolitical risk.
- Demand evolution and market competition.
- Relations with local communities.

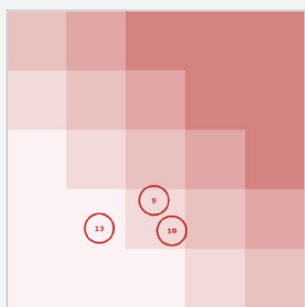
## MANAGEMENT ACTIONS

- Transformation and optimization projects to improve the efficiency and effectiveness of processes and operations in our industrial facilities, and to enhance integration and synergies between units.
- Strategies for optimizing production processes and improving efficiency, as well as research into developing new products with greater competitiveness and added value.
- Strict cost control in line with the current economic and pricing climate.
- Diversification of the exploration and production projects portfolio: to mitigate our exposure to geopolitical risk, Cepsa seeks to balance its portfolio of projects by extending its activities to different countries.
- Proactive management through follow-up of selected key indicators for a number of categories of identified risk sources, including: security, political stability, government effectiveness, legal and regulatory environment, fiscal policy and macroeconomics.
- Internationalization of activities: exploration of business alternatives in other international markets and emerging markets, in search of new opportunities, reducing risks from market exposure. An example of this is the fact that Cepsa will supply liquid natural gas (LNG) to ships via the first multi-product barge at a European level, or the launch of a new marine lubricant market.
- Strategies to optimize production processes and improve efficiency, and research for the development of new, more competitive products with higher added value.
- The birth of the Cepsa Foundation in 2016 as a demonstration of the social commitment of the Cepsa Group in those communities and towns where Cepsa operates.
- In 2016 Cepsa created Voluntus, a specific corporate volunteer program focused on caring for the environment, promoting employment and education, supporting culture, promoting sport and health and addressing basic needs.



### FINANCIAL AND MARKET RISKS

Derived from the volatility of commodity prices, exchange rates, interest rates and hedging and trading transactions, and those related to managing liquidity and solvency, and managing credit and counterparty risk.



- 9. Commodity price
- 10. Foreign exchange risk
- 13. Credit risk

### EXTERNAL CONTEXT AND THREATS

- 2016 maintained the decline in crude oil prices that began in 2014, listed at under \$30/bbl in January, the lowest level in 12 years, in part driven by the agreement reached by OPEC and Russia to limit crude oil production, prices saw a rise in the last part of the year, exceeding \$50/bbl.
- In November, OPEC finally agreed on a cut in oil production, the first since 2008, of more than a million barrels per day to drive up the cost of a barrel. The agreement entered into force on January 1, 2017 and will, in principle, be extended by six months.
- Cepsa's activities are generally sensitive to changes in the €/USD exchange rate, as most crude oil, petroleum and petrochemical product prices are based on the US dollar.
- Trump's protectionist policies and the evolution of the US economy, as well as the FED's position on the further increase in interest rates, may create a degree of volatility in the \$/€ exchange rate.

### RISKS

- Commodities price risk due to the volatility of oil and gas prices.
- Liquidity risk, foreign exchange rate and interest rate derived from the evolution of financial markets.
- Credit and counterparty risk.

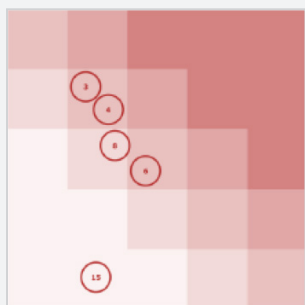
### MANAGEMENT ACTIONS

- Rethinking of the investments in line with the new situation and Brent outlook.
- Managing fluctuation risks through hedging arrangements that protect the Company against price swings.
- Adaptation to internal policies in accordance with the current scenario, enabling stricter price risk management.
- Strategies for optimizing production processes and improving efficiency, in order to maximize margins in such a volatile context.
- Vertical integration of Cepsa to minimize the impact of changes brought about by the economic cycle on specific business units or areas.
- Achievement of a sound financial situation enabling the Company to overcome potential fluctuations in the economic and industry scenarios.
- Minimization of the impact of foreign exchange risk on business operations (foreign exchange risk related to the net global situation of cash flows in foreign currency of Cepsa's various companies is managed on a centralized basis).
- Centralization of the sources of funding, investment of financial surpluses and instruments for hedging financial risk.
- Arrangement of most borrowings at variable interest rates (on the basis that within a general environment of stable interest rates this financing model will entail a lower long-term cost).
- Maintenance of credit lines and liquidity to ensure the Company can meet its payment obligations and manage any funding needs.
- Drafting and updating "Internal Standards and Procedures" to manage the risk related to arranging appropriate payment instruments.
- Arranging insurance policies to cover customer default risk in certain commercial areas.
- Implementing a credit quality assessment system for trade receivables and other customer assets determined on the basis of solvency and payment habits (high, medium or low quality).



### OPERATIONAL RISKS

Linked to the effectiveness and efficiency of operations, including the supply of products, goods and services, management of transport, extraction and manufacturing processes, sales and marketing, safety of people and property, respect for the environment, human resources and information technologies.



- 3. Operational security
- 4. Physical security
- 6. Security of information
- 8. Technological innovation and trends
- 15. Retention and attraction of talent

### EXTERNAL CONTEXT AND THREATS

- The economic climate, the situation in refining, geopolitical instability and the sharp drop in oil prices have accelerated the search for efficiency and cost reduction for exploration projects and efficiency in production processes.
- Growing concern and regulatory tightening in the environmental, quality, safety and health areas.
- Increased vulnerability of the Company as regards data protection in the current context of new technologies.

### RISKS

- Risk of not having the technology necessary to reach less accessible oil fields which would limit access to certain growth opportunities.
- Industrial, prevention and safety risks that can lead to accidents and incidents in Cepsa facilities.
- Environmental Risks derived from potential impact of our operations on the environment (air, water, soil and groundwater pollution, or during waste handling and processing, etc.).
- Risk related to talent retention and attraction associated with the existing level of competition in human resources and its suitability to meet strategic plans and growth targets.
- Risks related to information security.

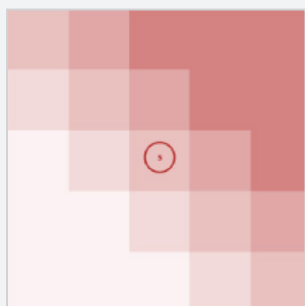
### MANAGEMENT ACTIONS

- Recent access to offshore exploration blocks. This is enabling Cepsa to gain experience in this type of operation in order to expand its presence in this type of asset in the future.
- Commitment to research and development by focusing on new technologies to increase the oil recovery factor at deposits (EOR project: Enhanced Oil Recovery), research projects into advanced biofuels, etc., all carried out at the Cepsa Research Center, or the opening of a new test laboratory in Palos de la Frontera (Huelva).
- Integration of safety along the command chain (set out in the "Basic Standard" and management system based on international specification OHSAS 18001: 2007).
- Application of the best safety practices, eliminating risk at source.
- Existence of insurance coverage for risks of material damage and loss of earnings derived from material damage, third-party liability and loss or damage in transportation of crude oil, products and equipment.
- Internal Environmental Protection Policy and Standard and certification by external agencies of the environmental management systems at all Cepsa's large industrial plants.
- Continued execution of projects aimed at improving the efficiency and reduction of the environmental impact of all Cepsa facilities and operations.
- Launch of various programs focused on development, training and performance assessment (MIDE or the 70/20/10 talent development program).
- Existence of recruitment policies and procedures (such as "Success Factors") ensuring equal opportunities and non-discrimination.
- Development and promotion of the company's initiatives aimed at making Cepsa an attractive place to work (Top Employer, Empresa Familiarmente Responsable certification (family responsible company), social benefits, etc.).
- Security arrangements to ensure the availability, completeness, confidentiality, supervision and auditing of information.
- Certification of the Company's Information Management Security System under the most stringent international standard (ISO 27001).



## REGULATORY AND COMPLIANCE RISKS

Related to the evolution of the regulations applicable to activities and/or the sector that may affect the structure under which activities are carried out and the results generated by the operations, compliance with regulations and internal policies and procedures of the Company are carried out. Non-compliance may directly affect the company's reputation and image and may result in disciplinary proceedings being initiated by the regulator.



### 5. Regulatory uncertainty and compliance

## EXTERNAL CONTEXT AND THREATS

- Law 8/2015, of May 21, amending Law 34/1998, of October 7, of the Hydrocarbon sector, introduced important new developments in various activities carried out by operators in the hydrocarbon sector, including their extraction, refining, the sale of petroleum products, liquefied petroleum gas and natural gas (natural gas wholesale market).
- On November 4, 2016 the Paris Agreement (COP 21) came into force, intended to strengthen the global response to the threat of climate change, setting emission reduction targets, in order to maintain the increase in the global average temperature below 2°C compared to pre-industrial levels.
- Also of importance in environmental matters is EU Directive 2009/28 on promoting the use of energy from renewable sources and European Law 2009/30 in relation to the specifications of petrol, diesel and gas-oil, to monitor and reduce greenhouse gas emissions.
- Regulatory changes. An example is the new MARPOL regulatory framework, which establishes limits on the sulphur content in marine fuels (max 0.5% S), coming into force in 2020, or the new form of financing of the bono social discount in the electrical sector, established in Royal Decree-Law 7/2016, which attributes the cost of the latter to the parent companies of corporate groups that sell electrical power.

## RISKS

- Infringements of the regulations applicable to the activities of the sector, as a result of its evolution.
- Unfair behavior or breaches of the applicable internal regulations, by our professionals, which could damage Cepsa's image and reputation.
- Regulatory changes for the evolution of the regulations and taxation applicable to Cepsa's activities and/or industry.

## MANAGEMENT ACTIONS

- Implementation of the "Basic Environmental Regulations" and the "Biodiversity Regulations" regulating the measures to be taken to preserve habitats and species in areas where the Company operates.
- Implementation of an environmental management system certified under UNE-EN ISO 14001.
- Cepsa has "Basic Regulations for the Prevention of Work and Industrial Risks", which, in addition to the legally required requirements, incorporates other principles considered necessary to achieve high levels of safety in its business areas.
- In the area of effective equality between women and men, in compliance with Law 3/2007, Cepsa has an Equality Plan negotiated with worker representatives, containing measures to ensure equal treatment and equal opportunities, and non-discrimination due to gender.
- With regard to the protection of competition, Cepsa has a "Compliance Program" adapted to the new criteria of the European Commission.
- Existence of a Code of Ethics and Conduct, updated in December 2016, that lays down the values and ethical principles that guide the Company and its professionals. Cepsa also has an Ethics Channel and a Complaints Investigation Procedure.
- Development of internal regulations and procedures on environment, biodiversity, health and safety and prevention of occupational risks, to guide professionals' actions ensuring compliance with legal requirements and incorporating additional measures to achieve high levels of safety and environmental protection.
- Anticipating and adapting to regulatory changes: to minimize the impact of the regulations, Cepsa tries to get ahead of the market when faced with a change, and adapts to the new requirements as quickly as possible.