2018-05-30 | Rating Action Commentary

Fitch Affirms Cores at 'A-'; Outlook Stable

Fitch Ratings-Barcelona/London-30 May 2018: Fitch Ratings has affirmed Corporacion de Reservas Estrategicas de Productos Petroliferos' (Cores) Long-Term Local- and Foreign-Currency Issuer Default Ratings (IDRs) at 'A-' with Stable Outlooks and Short-Term Foreign-Currency IDR at 'F1'. The ratings on the senior unsecured outstanding bond issues and EMTN programme have been affirmed at 'A-'.

Under its Government-Related Entities (GRE) Rating Criteria, Fitch considers Cores' parent, the Spanish government (A-/Stable/F1), has very high ability and willingness to provide support. Using a top-down approach and our assessment of four factors under the strength of linkage and incentive to support by the ultimate parent we have aligned Cores' IDRs with those of Spain.

KEY RATING DRIVERS

Under the criteria we assess the strength of linkage in status, ownership and control, as well as support track record and expectations; and the incentive to support, which covers the socio-political and financial implications of a GRE's default.

Status, Ownership and Control- Assessed as Strong:

Cores was created in 1994 under the particular status of a non-profit public corporation without equity, tightly controlled by the central government.

The central government's strong influence on and control of Cores' operations is demonstrated by the supervision of the Ministry of Energy, Tourism and the Digital Agenda (Ministry of Energy), through its veto right on any agreement on Cores that could infringe the legality or public interest. However, it has never used this as there is usually a strong consensus within the board of directors.

The strong influence and control is also reflected by the relevant presence of the central government on Cores' board of directors, as four of 11 members are appointed by the Minister of Energy. Cores' President is also appointed by the Ministry of Energy and has a five-year mandate, which can be renewed for a further five years. The president's main function is to be the legal representative of Cores in all its acts and contracts and manage the inspection of its activities.

Cores' has no shareholder from the central government and in case of dissolution the central government would not be involved, without liability transfer. However, Cores' accounts and debt are consolidated in Spain's national accounts. Cores' budgets and borrowing are approved by its board of directors. However, the Ministry of Energy approves the fees charged to operators through Cores' budget elaboration process.

Support Track Record and Expectations- Assessed as Very Strong:

Fitch believes that the regulatory influence is strongly supportive of Cores' financial stability and viability, as the operators are obliged by law (according to the item 25.4, of the Royal Decree 1716/2004) to pay at any time an increase of fees to guarantee Cores' creditworthiness for the coverage of total spending, including debt servicing. The law also stipulates that Cores can at any time sell reserves storage that exceeds the mandatory level to cover debt servicing. Excess reserves were estimated by Cores at EUR277 million at the end of 2017, representing about 9% of total reserves at market value.

Socio-Political Implications of Default- Assessed as Very Strong:
Oil is crucial for the domestic energy supply, representing 44% of primary energy consumed in Spain. Spain is obliged to maintain 90 days of net imports of crude oil and petroleum according to the European Union (EU) requirement, a target that was increased by the Spanish government to 92 days of sales or consumption. Cores is the designated central stockholding entity for maintaining energy in Spain, obliging it to maintain at least 42 numbers of days of reserves of the obligation and therefore the industry maintains 50 days. Cores' main mission also consists of controlling and inspecting the level of Spain's security reserves held by operators to ensure the minimum stock of obligation.

This factor reflects the fact that Cores' financial default would materially endanger continued provision of its activity, impacting its borrowing capacity, considering that Cores funds its purchase of reserves with debt borrowing. This factor also reflects the fact of a lack of any immediate substitute to maintain Cores' obligation of 42 days, given the complexity of necessary legal changes, the economic and financial difficulty for private operators to assume Cores' obligation and the non-transferability of controlling and inspecting reserves held by operators.

As a result, Cores' default would be seen as of significant importance for the Spanish government, as it would fail its obligation of maintaining a minimum of 90 days as imposed by the EU. This would have a significant international public reputational effect, economic sanctions, significant national vulnerability in case of oil supply crisis and grave national economic repercussions, due to Spain's energy dependence.

Financial Implications of Default- Assessed as Strong:
This factor reflects the fact that the Spanish government would have a strong incentive to provide extraordinary financial support to prevent a default of Cores as the default would have a significant impact on Spain's credit international reputation in failing to meet the EU target. It would also have grave economic repercussions and therefore affect its availability and cost borrowing.

The factor also reflects the fact that Cores' accounts are consolidated in Spain's debt in national public terms. Cores' default would also have a significant impact on its availability of borrowing, as the corporate is mostly financed in capital markets (73% of outstanding debt at end of 2017), risking failure to meet the EU target.

This assessment under the GRE criteria has resulted in 45 points, leading Fitch to align the ratings with the sovereign's IDRs, irrespective of the standalone credit assessment.

As Cores maintained reserves above requirement in 2016 and 2017, it decided to sell reserves. The sale, previously authorised by the Ministry of Energy, generated EUR144 million in 2016, and the regulatory framework imposes that the proceeds of reserve sales are first applied to debt reduction. Consequently, Cores' outstanding debt declined to EUR1.8 billion in 2016 (EUR2.1 billion in 2015) as it allowed EUR88 million of a long-term loan maturity from 2016 to be repaid. Outstanding debt increased to EUR2.1 billion in 2017 and cash reserves amounted to EUR441 million, with EUR200 million of available credit lines.

Cores' profitability is not as high, since the corporation is non-profit. Typically, Cores reduces fees charged to operators (fees collected from the operators more than covering operating spending), in the last quarter of the year. For instance in October 2017, Cores decided to reduce fees for liquid hydrocarbon products by 22%, and reported a profit of EUR17.7 million in 2017 (EUR40.4 million in 2016).

RATING SENSITIVITIES

Changes to the state's IDRs will be mirrored in Cores' IDRs, assuming that the links between the sovereign and the company remain strong. Looser links between Cores and the sovereign could also lead to a widening of the notching differential.

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Applicable Criteria

Government-Related Entities Rating Criteria (pub. 07 Feb 2018)

Rating Criteria for Public-Sector, Revenue-Supported Debt (pub. 26 Feb 2018)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy