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Corporacion de Reservas Estrategicas de Productos Petroliferos

Primary Credit Analyst:
Lorenzo Pareja, Madrid (34) 91-389-6962; lorenzo_pareja@standardandpoors.com

Secondary Credit Analyst:
Sarah N'Sonde, Paris (33) 1-4420-6665; sarah_nsonde@standardandpoors.com

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Corporacion de Reservas Estrategicas de Productos Petroliferos

Major Rating Factors

Issuer Credit Rating
AAA/Stable/A-1+

Strengths:

- High strategic importance for the state and Spanish economy
- Very strong legal and regulatory status
- Solid and predictable funding profile

Weaknesses:

- Lack of explicit guarantees from the state
- Limited asset diversification

Rationale

The ratings on Corporación de Reservas Estratégicas de Productos Petrolíferos (CORES), the public entity responsible for Spain's strategic oil reserves, are equalized with those on the Kingdom of Spain (AAA/Stable/A-1+) and based on expected continued state support. This expectation is justified by CORES' strategic importance for the national economy given that Spain's oil imports cover nearly 100% of the country's consumption needs. Consequently, CORES benefits from a strong legal status as a public entity, which implies tight supervision by the Spanish state and the latter's ultimate responsibility for all of the entity's obligations. Equally important, CORES enjoys a supportive regulatory environment, characterized by a full-cost, fee-based funding system that provides it with a predictable and flexible financial profile.

CORES' legal mandate is to ensure compliance with obligations under Spanish law and international regulations regarding the strategic stockholding of oil and gas products. CORES was established in 1994 as a public entity and its legal status can only be changed by law.

CORES does not receive any funds from the government, nor does it benefit from any explicit state guarantee on its liabilities. The law does not preclude, however, the state's granting financial support to CORES in a potential stress scenario.

The entity is funded exclusively through the monthly quotas it receives from its members. All oil and gas operators and importers in Spain are required by law to pay fees to CORES; failure to do so can eventually result in the termination of an operator's license. By law, fees are set to cover all operating, financial, and administrative costs. In the event of unforeseen circumstances that could put CORES' liquidity and/or solvency at risk, the government is entitled by law, at any time, to charge an extraordinary fee to CORES' members.

CORES borrows funds in the international financial markets to finance the purchase of oil stocks. Total debt should reach some €1.7 billion at year-end 2008, with no currency risk. Further debt increases are likely and will continue to finance CORES' legal requirement to build up 45 days' consumption of oil reserves by 2011.

Liquidity

CORES has limited need for short-term credit lines for operating purposes because member fees are paid monthly. However, the corporation has two committed credit lines from Banco Bilbao Vizcaya Argentaria, S.A. (BBVA; AA/Stable/A-1+), for €30 million and €250 million--both of them unutilized as of Oct. 13, 2008.

Outlook

The stable outlook mirrors that on the Kingdom of Spain and reflects CORES' strategic role in the Spanish economy given that imports cover nearly 100% of the country's oil consumption needs. Hence, we expect CORES to continue to receive strong implicit government support in the form of its special legal and regulatory status.

We expect CORES' total debt to increase to about €1.7 billion by year-end 2008 as CORES continues to enlarge its strategic oil reserves. However, CORES' financial solvency and liquidity are likely to remain strong, as all of the entity's costs--including financial costs--are covered by fees, which, at current levels, we expect the members to easily pay.

The sovereign credit ratings could come under pressure--and therefore so could the ratings on CORES--if the government debt ratio increases sustainably toward the median for 'AAA' sovereigns or progress in liberalizing labor and product markets fails and results in Spain's prosperity falling further behind that of its 'AAA' rated peers.

Background And Business Description

Spain imports almost 100% of its oil consumption needs, resulting in high dependence on foreign supplies and risk associated with a potential disruption of international oil supply links. The Spanish government addressed this need as early as 1927, by maintaining minimum-security oil reserves. This strategic policy has essentially been maintained to date.

Also, as a member of the International Energy Agency and the EU, Spain must maintain minimum stocks for three groups of oil products, equivalent to 90 days of supply and consumption (for the list, see "Operations" below), calculated based on the average consumption levels in the previous year.

The Spanish government shares the holding of such minimum-security reserves together with the sector's operators. This differs from policy in other EU countries like Germany, where all minimum-security reserves are held solely by the state, either directly or indirectly through state-owned entities such as the German state-owned Erdoelbevorratungsverband (AAA/Stable/A-1+).

Government mandate to CORES

The Spanish government created CORES in 1994 by royal decree, granting it a mandate to constitute, maintain, and manage the minimum-security oil stocks held by the Spanish government.

Since 2007, CORES is required to maintain a stock of at least 37 days of national oil-product consumption; the stocked oil products should reach 45 days by 2011. The remaining stock (to reach the national requirement of 90 oil consumption days) must be held by the oil operators, retail distributors, and consumers of imported oil. CORES is also responsible for ensuring that the oil operators fulfill their minimum-reserve obligations.

CORES is also obliged to: insure its strategic oil reserves fully; maintain the stocks' quality and adequacy for consumption at all times; store the stocks evenly throughout Spanish territory; and keep the stocks readily available for immediate release in the event of an imminent or existing disruption of oil supplies. In a crisis scenario, it is the government's responsibility to establish by decree the use and release procedures of the minimum-security reserves, including CORES' strategic oil reserves.

CORES' mandate also includes the supervision of gas operators to ensure that they meet their obligations regarding liquid petroleum gas (LPG) and natural-gas minimum-reserve requirements (set at 20 days, respectively), and that no more than 50% of gas resources are provided by any one country. Reflecting the new mandate, CORES' board of directors has increased its number to incorporate new representatives from the gas sector and the energy sector regulator, the Comisión Nacional de Energía.

Legal Status

CORES' legal status is strong: As a public-law entity fully owned by the Kingdom of Spain, it can neither be privatized nor go bankrupt. Its legal status can only be changed through parliamentary approval. Given the entity's strategic role and the increased requirement in strategic oil reserves held by CORES, the risks of change in legal status and privatization are negligible.

CORES is subject to the supervision of the Spanish government under the tutelage of the Ministry of Industry. Due to its strategic importance, CORES' governing laws restrict its activities to those of a special-purpose entity with a clearly defined strategic role. For efficiency reasons, CORES is subject to private commercial laws and has a large degree of operational independence, however.

CORES does not receive any public funds, and the state does not grant any explicit guarantee for the company's liabilities, even though it could do so according to current law. Although the state is ultimately liable for CORES' obligations, only CORES' members financially support the entity's operations and debt repayment.

Government Role, Organization, And Management

The Ministry of Industry nominates CORES' president for a five-year term, which is to end in October 2009. The government also has to approve the entity's annual accounts and set the unit quotas that will determine the fees paid by CORES' members and nonmembers. By law, the unit quotas must cover all CORES' operational, financial, and administrative expenses. Moreover, CORES' budgeting practices are conservative and overstate costs. Consequently, levied fees are usually in excess of the actual costs. Furthermore, the Ministry of Industry is also entitled to impose an extraordinary quota on CORES members at any time and for any period if CORES' financial position and solvency are at risk for any reason. No extraordinary quotas have been imposed to date because the budget is drafted so that ordinary quotas include a reasonable cushion for cost increases.

Operationally, CORES requires the government's authorization to release any strategic oil reserves if stock levels are below the legal required level: 37 days until 2011 and 45 days thereafter. (See "Stock release procedures" within "Operations" below).

The general assembly comprises CORES members. Voting rights are proportional to the annual quota paid by each member. The Ministry of Industry has a right of veto. Any agreement requires three-quarters of members' votes. So far, the ministry has never exercised its right of veto at the general assembly.

The board of directors is composed of the president and 11 members: Four are nominated by the Ministry of Industry, and seven by the general assembly (five represent operators in the oil sector, one the gas sector, and one the LPG sector). Decisions require the presence of seven board members, and a simple majority applies. The president has a right of veto over any agreement reached by the board that is contrary to existing laws.

Operations

Stockholding and storage operations

Minimum-security reserves are held for three different oil products: gasoline, middle distillates (diesel, kerosene, and jet fuel), and heavy fuel oils. Reserve requirements for each product category are recalculated every month and basically correspond to the 90-day average of sales and consumption in the preceding calendar year.

CORES' recent obligation to increase stocks to create at least the 45-day reserves can be fulfilled through acquisitions in the open market and, up to a maximum of 50% of total strategic reserves, through leasing contracts with oil operators. At present, CORES has only two storage facilities of its own, which account for a minor share of its total stocks. Most of the stocking capacity is rented from third parties. Investment in own oil stores will allow CORES to save on storage costs, while increasing the currently limited storage capacity for Spain's oil market.

The leasing of stocks and renting of storage capacity must be carried out so as not to alter prices or market conditions. In addition, CORES' members are obliged to sell and lease stocks and rent storage capacities as required by CORES. To date, no member has refused to cooperate with the company.

Stock release procedures

Any profits derived from the sale of oil products must be allocated to a special reserve, and sale proceeds are to be applied to early debt amortization. On Dec. 31, 2007, the special reserve amounted to €36.8 million. Since the creation of CORES, stocks have never been released due to a disruption or crisis affecting the supply of oil, or at the discretion of the entity, given that it is still far from achieving its 45-day stock goal.

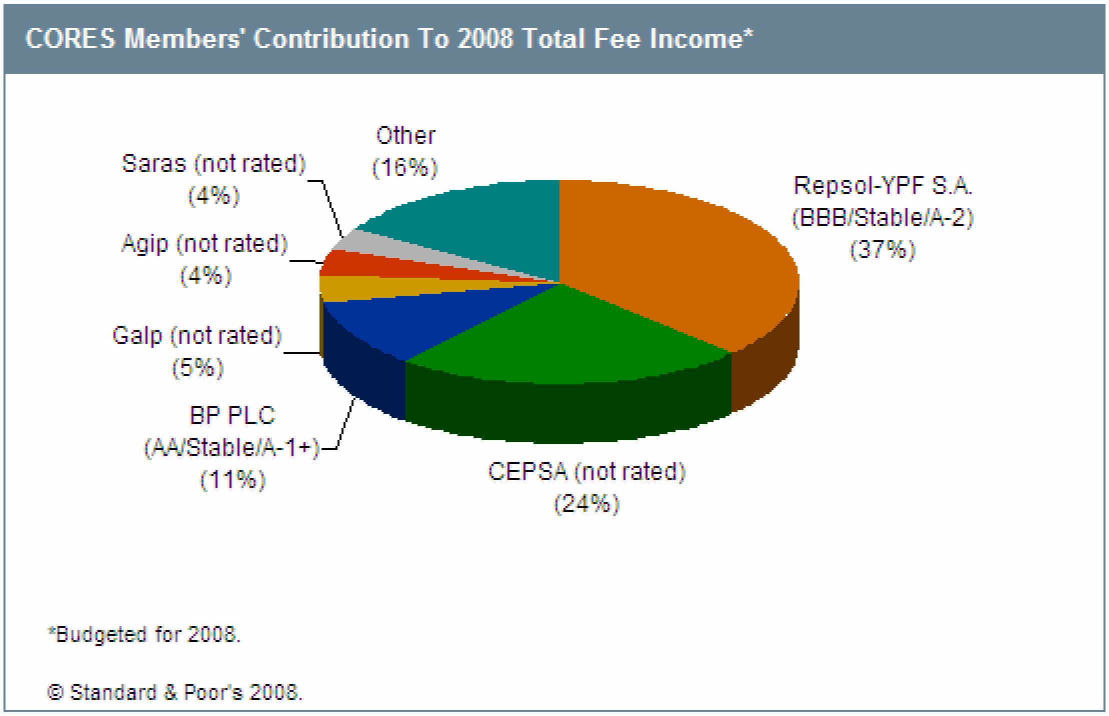
CORES finances its purchases of oil products through borrowed funds.

Membership And Fee System

Membership

All oil operators authorized to distribute oil products and liquefied petroleum gas (LPG) and, since 2004, natural gas operators in Spain are legally obliged to be members of CORES. Retail distributors and consumers of imported oil and gas products are obliged to pay monthly fees to CORES but do not have member status. The number of CORES members has increased to 100 from 41 at year-end 2003, largely due to the incorporation of members from the LPG and natural gas sectors. Members from the oil sector, however, continue to contribute almost 99% of the company's total fee income (see chart 1).

Chart 1



Fee system

The law requires fees to be calculated so as to cover all the corporation's costs: financial, operational, administrative, and those associated with allocation to the statutory reserve. This full-cost pricing ensures CORES' financial viability despite sharp increases in costs, because the quota does not represent a material cost to any member. Since 2007, the board of directors may decide on raising fees by as much as 5% during a year, for the purpose of adapting CORES' stream of income to current circumstances. Nevertheless, CORES maintains veto power over decisions to modify fees.

Termination of license to operate in the Spanish oil sector, for members that do not comply with fee payments

Member and nonmember fees, payable monthly without notice, are calculated based on unit quotas to the volume of metric tons of products sold or consumed in the preceding month by each member and nonmember. In the event of delayed payments, CORES charges a penalty of 300 basis points over the legal Spanish interest rate (5.5% as of August 2008) for the duration of the payment moratorium. By law, failure to settle the fee is a grave infraction. The Ministry of Industry will take action against the operator, which could eventually result in the termination of its license. Given this incentive, the rate of nonpayment is expected to remain nil or negligible.

CORES' board of directors must elaborate a nonbinding balanced annual budget, with the sole purpose of proposing unit quotas. The budget must include projections of all costs. These costs must be allocated to the oil product categories in proportion to the projected strategic reserve requirements for each category. In turn, fees receivable from sales and consumption of each type of product must cover projected expenditures per product category. Unit quotas per metric ton of product sold and consumed are then calculated, dividing the projected total fee income per product category by the projected volume of oil sales for the budgeted year.

Extraordinary fees to avoid financial straits

The quotas are made official and legally binding by ministerial order in December or early January of the budgeted year. If CORES' actual expenditures (or revenues) turn out to be higher (or lower) than projected, or if unforeseen circumstances put CORES' liquidity at risk, the Ministry of Industry is entitled to impose an extraordinary quota on CORES' members and nonmembers. To date, no extraordinary quota has been approved given the conservative policy for setting unit quotas, which has resulted in fee surpluses every year since CORES began operations.

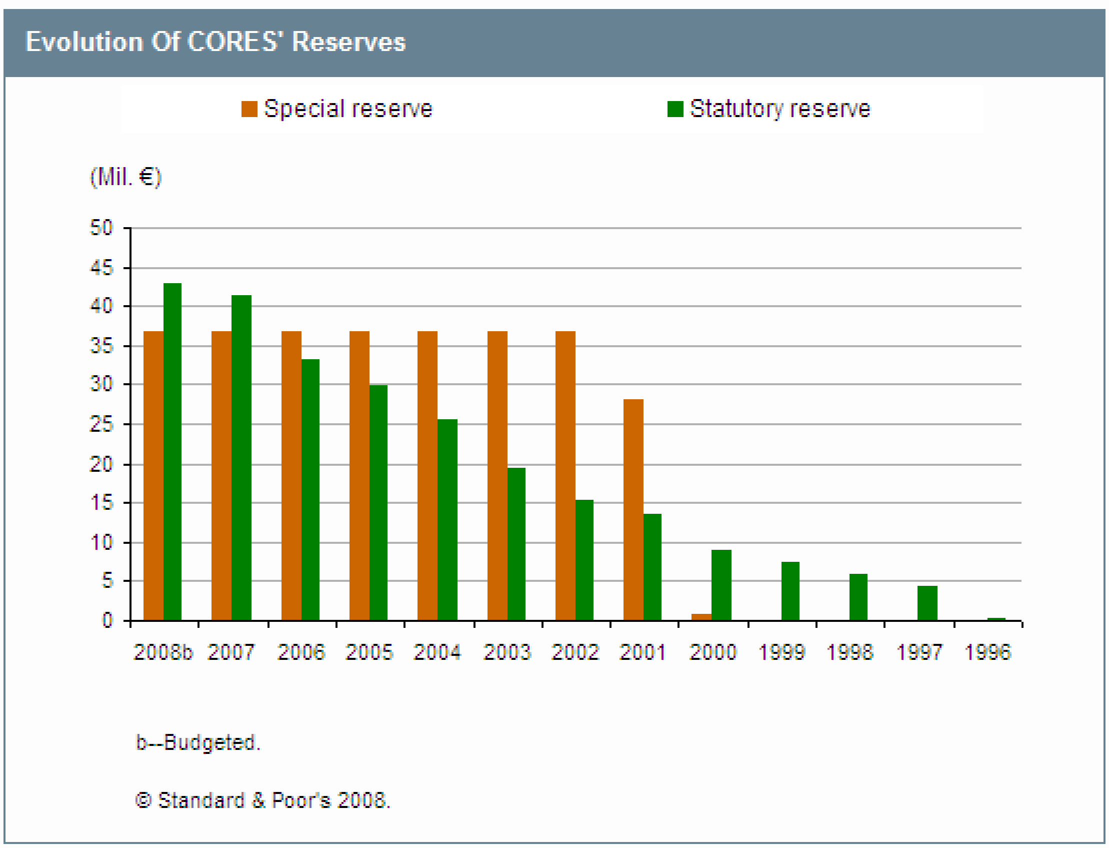
Excess fees

Given that CORES' budgeting is conservative, the company tends to generate excess fees and net profits. CORES' board of directors decides whether any of the excess fees are to be paid back to the members, and it allocates the remaining surplus to the statutory reserve. Although members have never demanded that CORES should return excess quotas, the board of directors usually decides to do so as a signal of its willingness to contain fee levels. Accordingly since 2003, CORES has annually returned to members about 1% of budgeted revenues.

Growing reserves

CORES' management devotes a material part of its net income to enlarge the net worth of the company through a statutory reserve, so that it amounts to 25% of total budgeted expenditure in the year. At year-end 2007, the statutory reserve amounted to €41.2 million (see chart 2). Total net worth was €79.6 million at year-end 2007.

Chart 2



Since CORES' creation, defaulted payments have been immaterial, and members have routinely complied with payment obligations. At year-end 2008, overdue fees are expected to have been nil. Penalty charges for delayed payments are usually negligible, and mostly due to administrative errors of minor importance. CORES relies on Repsol-YPF S.A. (BBB/Stable/A-2) and Cepsa (not rated), the two largest oil operators in Spain, for more than 60% of its annual fee income, although quotas paid to CORES by the operators represent a minimal amount of their annual total expenses. The share of these two operators in CORES' total fee income should gradually decline--as has happened in recent years--as the Spanish oil market becomes more competitive. The concentration of CORES' fee income among a small number of operators does not pose a significant risk to its financial and funding profile, due to the special features of the entity's funding system.

Provisions against member bankruptcies

If an oil operator goes bankrupt, it ceases to operate in the market and competitors take over the failed operator's market share. The quotas due each month by members are calculated by applying the unit quotas to volumes of oil products sold in the previous calendar month by each operator, and so each member's monthly quota is automatically adjusted to reflect any changes in the market structure. Any disruptions to CORES' revenue stream should be of short duration and would be unlikely seriously to affect the company's ability to carry out its operations. In any case, the Ministry of Industry can set an extraordinary quota on members and nonmembers of CORES if circumstances require.

Finances

Table 1

Corporacion de Reservas Estrategicas de Productos Petroliferos Financial Summary*

	--Fiscal year ended Dec. 31--				
	2007	**2006**	**2005**	**2004**	**2003**
Rating history	AAA/Stable/A-1+	AAA/Stable/A-1+	AAA/Stable/A-1+	AAA/Stable/A-1+	AA+/Positive/A-1+
(Mil. €)					
Revenues	163.8	139.6	110.5	98.9	99.4
Net income from continuing operations	1.6	8.0	3.5	4.5	5.9
Funds from operations (FFO)	0.1	9.1	3.6	4.6	6.0
Capital expenditures¶	275.3	248.3	306.1	8.5	0.5
Debt	1,484.4	1,176.6	976.3	676.9	687.2
Equity	79.6	78.0	70.0	66.6	62.3
Adjusted ratios					
Oper. income (bef. D&A)/revenues (%)	34.8	29.9	20.4	20.6	24.5
EBIT interest coverage (x)	1.0	1.2	1.2	1.3	1.3
EBITDA interest coverage (x)	1.1	1.3	1.2	1.3	1.3
Return on capital (%)	4.0	3.6	2.5	2.7	3.3
FFO/debt (%)	0.0	0.8	0.4	0.7	0.9
Debt/EBITDA (x)	26.0	28.2	43.3	33.3	28.2

*Fully adjusted. ¶Includes inventories.

Profit-and-loss account

CORES' largest operational expenditures are the maintenance and storage of the strategic stocks (€103.6 million for 2007), which accounted for 64% of total operational costs (see table 1). This cost is expected to rise 17% in 2008 following the gradual buildup of oil reserves (toward the 45-day target in 2011). Interest expenditures have increased gradually since CORES' creation, reflecting the buildup of oil reserves through debt financing. With debt set to rise to around €2.2 billion by year-end 2008, CORES expects interest expenditures to accelerate to €77 million at year-end 2008 from €33 million at year-end 2006. Personnel costs, an estimated €2.4 million on Dec. 31, 2008, and stock wastage, €1.7 million (see table 2), together should represent just 2.0% of total operational costs.

Table 2

Corporación de Reservas Estratégicas de Productos Petrolíferos Financial Ratios

	--Year ended Dec. 31--						
(%)	2007	2006	2005	2004	2003	2002	2001
Balance sheet							
Growth of assets	21.0	23.1	40.0	(0.3)	0.0	9.8	24.2
Growth of financial liabilities to banks and other creditors	21.0	23.2	40.0	(0.3)	0.0	10.1	24.0
Liquidity and reserves							
Reserves and retained earnings/liabilities	5.2	6.3	7.0	9.5	8.8	7.9	8.1
Market value of oil stock / total debt (x)	2.2	1.6	2.0	1.7	1.3	1.5	N.A.
Cash plus short-term assets/interest payments	0.0	0.0	0.3	0.0	62.6	48.4	46.2
Cash plus short-term assets/total operating expenditures	0.0	0.0	0.0	0.0	12.7	12.3	13.6
Statutory reserve (in months of membership fees)	3.0	2.9	3.2	3.1	2.4	1.8	1.8
Profitability							
ROA (surplus/assets)	0.1	0.6	0.3	0.6	0.8	0.6	1.5
Surplus/revenues	1.0	5.9	3.2	4.3	5.9	4.3	10.4
Growth in earnings (surplus)	(80.0)	126.0	(18.9)	(27.4)	37.5	(58.4)	(67.8)
Structure of revenues and expenditures							
Administrative costs/total expenditures	2.7	2.8	3.0	4.2	2.8	2.7	4.0
Interest payments/total expenditures	33.5	25.2	17.8	16.6	20.3	25.4	29.4
Storage costs/total expenditures	63.9	72.1	79.2	79.2	76.8	71.9	66.7
Membership fees/total revenues	99.9	101.1	100.0	98.5	99.2	100.8	91.8
Surplus brought forward/total revenues	1.0	5.7	3.2	4.3	5.9	4.3	10.4
Average cost of financial liabilities							
Interest payments/long-term liabilities	5.7	5.8	2.8	2.4	2.9	3.7	4.2

e--Estimated.

Fee income, estimated at €235.0 million in 2008 (€163.8 million in 2007), should account for 100% of total operating income. Although the budget has to balance operational costs and revenues, CORES has always run a fee surplus, part of which is usually paid back to members, with the remainder allocated to the statutory reserve. In 2008, profit (before refunding to members) may reach a high of €31.8 million; the increase in 2008's expected profit was driven by some delays in stock building during the first quarter of 2008 that entailed lower operating expenses. A large part of this net income will, however, be refunded to members after CORES makes its regular contribution to the statutory reserve (see "Fee system" above). After refunding to members, the average net profit has reached an average of €4.7 million over 2003-2007. Profits from the sale of stocks are allocated to the special reserve and cannot be distributed to members.

Balance sheet

Table 3

Corporación de Reservas Estratégicas de Productos Petrolíferos Profit And Loss Account

	--Year ended Dec. 31--					
(Mil. €)	**2007**	**2006**	**2005**	**2004**	**2003**	**2002**
Income	161.9	139.6	110.5	98.9	99.4	101.8
Membership fees	163.7	139.6	110.5	98.9	99.4	101.8
Other income and change in stocks	(1.80)	(1.5)	(1.3)	(1.1)	(1.1)	(1.0)
Financial income and other	0.0	0.0	0.0	0.1	0.8	0.2
Expenditures	160.3	130.7	107.0	95.8	94.2	97.7
Maintenance of stocks	101.7	94.3	84.7	75.9	72.3	70.2
Financial expenditures	54.2	32.9	19.0	15.9	19.2	24.8
Personnel and Administrative expenditures	4.4	3.5	3.3	4.1	2.7	2.6
Net profit	1.8	8.2	3.5	4.3	5.9	4.3
Sales of stocks	0.0	N.A.	0.0	0.0	0.0	0.0
Excess fees	12.0	N.A.	3.5	4.2	5.1	4.1
Financial operations and others	N.A.	N.A.	0.0	0.1	0.8	0.2

e--Estimated. N.A.--Not available.

At year-end 2007, CORES' strategic oil reserves, estimated at €1,552 million, will represent 97% of total assets (the same percentage as in 2006). Oil stocks are valued at average acquisition cost. At year-end 2007, the market value of CORES' stocks was €3,303 million, compared with €1,552 million at average acquisition cost. This constitutes a considerable hidden reserve. Nevertheless it is unclear whether CORES will partly liquidate its strategic oil reserves, even in the case of financial distress.

CORES' long-term debt was €960 million at year-end 2007, higher than in 2006 (€572 million) (see table 3). The long-term debt increase relates to the construction of the new storage facilities and buildup of reserves. In 2008, CORES issued a €500 million bond and may to contract up to €595 million in short-term credit lines for the same purpose; at year-end 2008 total debt should increase to around €1.7 billion. CORES will likely refinance short-term debt in 2009 through new bond issuance or a syndicated long-term loan. CORES' maturity profile (see Chart 3) shows sizable repayments in 2013 and 2018. As the company increases its debt burden, member fees will increase; the raise in fees would, however, continue to be immaterial for CORES' members, especially if compared with the consequences of nonpayment (the loss of operating license in the Spanish market).

Table 4

Corporación de Reservas Estratégicas de Productos Petrolíferos Profit And Loss Account

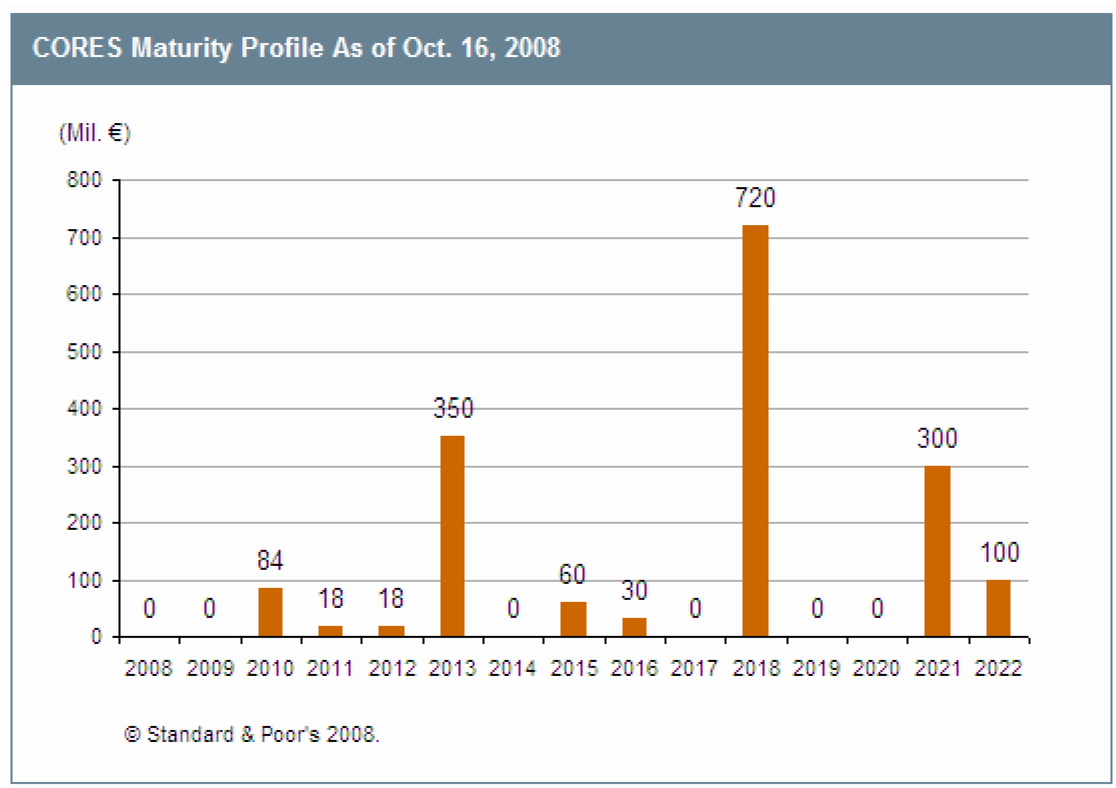
	--Year ended Dec. 31--					
(Mil. €)	**2007**	**2006**	**2005**	**2004**	**2003**	**2002**
Income	163.8	139.7	111.2	99.1	100.2	102.0
Membership fees	163.7	139.7	110.5	98.9	99.4	101.8
Financial income and other	0.1	0.0	0.7	0.1	0.8	0.2
Expenditure	162.3	131.7	107.7	94.9	94.2	97.7
Maintenance of stocks	103.6	95.0	84.7	75.9	72.4	70.2
Financial expenditures	54.3	33.0	19.0	15.9	19.2	24.8
Stocks and personnel	4.4	3.7	4.0	3.1	2.7	2.6

Table 4

Corporación de Reservas Estratégicas de Productos Petrolíferos Profit And Loss Account(cont.)						
Corporate tax*	0	0	0	0	0	0
Net profit	1.6	7.9	3.5	4.3	5.9	4.3

*CORES is corporate tax-exempt.

Chart 3



All of CORES' borrowings are denominated in euros. Reflecting the state support provided by its legal framework, CORES has access to the Spanish financial markets on very favorable terms. CORES has limited need for short-term credit lines for operating purposes, because member fees are paid monthly. However, the corporation has two committed credit lines from BBVA for €30 million and €250 million--both of them unutilized as of Oct. 13, 2008.

CORES' special legal status implies that the entity does not have capital, but the law obliges it to build up a financial reserve, which, by year-end 2007, amounted to €78.0 million (including the special and statutory reserves).

Ratings Detail (As Of November 18, 2008)*	
Corporacion de Reservas Estrategicas de Productos Petroliferos	
Issuer Credit Rating	AAA/Stable/A-1+
Senior Unsecured (3 Issues)	AAA
Issuer Credit Ratings History	
13-Dec-2004	AAA/Stable/A-1+
31-Jul-2003	AA+/Positive/A-1+
24-Sep-2002	AA+/Stable/A-1+

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard

Ratings Detail (As Of November 18, 2008)***(cont.)**

& Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

Additional Contact:
International Public Finance Ratings Europe; PublicFinanceEurope@standardandpoors.com

Additional Contact:
International Public Finance Ratings Europe; PublicFinanceEurope@standardandpoors.com