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Corporacion de Reservas Estrategicas de Productos Petroliferos

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Table Of Contents

Corporacion de Reservas Estrategicas de Productos Petroliferos

Major Rating Factors

Issuer Credit Rating
AA+/Negative/A-1+

Strengths:

- "Almost certain" likelihood of timely, sufficient extraordinary government support in the event of financial stress.
- High strategic importance for the Spanish state and economy.
- Strong legal and regulatory status.
- Solid and predictable funding profile.

Weaknesses:

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

Rationale

The 'AA+' rating on Corporación de Reservas Estratégicas de Productos Petrolíferos (CORES) is based on an equalization with the long-term rating on the Kingdom of Spain (AA+/Negative/A-1+), reflecting Standard & Poor's Ratings Services' opinion that there is an "almost certain" likelihood that the Spanish government would provide timely and sufficient extraordinary support to CORES in the event of financial stress.

In accordance with our criteria for government-related entities (GREs), our rating approach is based on our view of CORES':

- "Integral" link with the Spanish government. CORES is a public-law entity, tightly controlled and supervised by the Spanish Ministry of Industry. We see CORES as an extension of the government, specifically mandated to build up, manage, and control the nation's strategic oil reserves, in accordance with the EU and international legislation. CORES does not receive funds from the government, nor does it benefit from any explicit guarantee on its liabilities. However, the government provides CORES with what we deem to be strong ongoing support in the form of a regulatory framework under which oil and gas operators have the obligation to pay whatever fees are necessary to fully cover all of CORES' costs--including debt service. Standard & Poor's believes that this framework would safeguard a smooth sovereign takeover of CORES' obligations if needed.
- "Critical" role as an entity specifically formed to provide a strategic public service on behalf of the Spanish government. CORES has a specific mandate to monitor the level of Spain's oil reserves--virtually all of which come from imports--and ensure that they are sufficient to cover the country's oil consumption needs. Only the government itself can, in our opinion, undertake CORES' mandate.

CORES borrows funds in the international financial markets to finance the purchase of oil stocks. We estimate that total debt is likely to have reached some €1.9 billion at year-end 2009, with no currency risk. We understand from CORES that it plans to place a €0.5 billion bond in 2010. In our opinion, further debt increases are likely, in light of CORES' strategy to continue to build up security stocks.

Liquidity

CORES has limited need for short-term credit lines for operating and debt servicing purposes, since the government budgets the fees that CORES receives to fully cover all costs, and members pay the fees monthly. Moreover, CORES' budgeting is often conservative; hence, fees surpass effective costs (CORES returns the excess to operators at year-end). However, CORES does borrow for investment purposes (i.e., stock building), and took on €243.5 million in short-term credit lines at year end in 2009 in this respect. Committed credit lines from Banco Bilbao Vizcaya Argentaria, S.A. (BBVA) and Crédit Agricole Corporate and Investment Bank (formerly Calyon) represent some €515 million. We understand that CORES will replace this short-term debt with the proceeds of a €500 million bond that it will issue shortly.

CORES' debt amortization profile involves long-term debt repayment of €84 million in 2010 and €18 million in both 2011 and 2012. In 2013 and 2018, CORES faces debt repayments of €350 million and €500 million, respectively.

Outlook

The negative outlook on CORES mirrors that on Spain, which, in turn, reflects the risk of a downgrade within the next two years in the absence of more aggressive actions by the authorities to tackle fiscal and external imbalances.

We could revise the outlook on Spain, and hence CORES, to stable if the government announces concrete fiscal measures that we believe could credibly achieve annual primary surpluses of 2% or higher by 2012.

Government Support And GRE Methodology Impact

We rate CORES in accordance with our GRE methodology. The rating on CORES reflects our opinion that there is an "almost certain" likelihood that the Spanish state would provide timely and sufficient extraordinary government support to CORES in the event of financial distress. We base this opinion on what we see as ICF's integral link with, and critical role for the Spanish state.

Security oil reserves

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 risk as early as 1927 by constituting minimum-security oil reserves, and has essentially maintained this strategic policy 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 (for the list, see "Operations" below). These minimums are equivalent to 92 days of supply and consumption, calculated based on the average consumption levels in the previous year.

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

Government mandate

The Spanish state 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 state. We view this mandate to be of critical importance for the country.

Since 2007, CORES must, by national law (which follows EU regulation), maintain at any given time a stock of at least 37 days' worth of national oil product consumption; this requirement holds until year-end 2010. Thereafter, the minimum should, according to regulation, rise to 45 days. The remaining stock (to reach the national requirement of 92 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.

In addition, CORES has the obligation to:

- Fully insure its strategic oil reserves,
- Maintain the stocks' quality and adequacy for consumption at all times,
- Store the stocks evenly throughout the 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, it is the government's responsibility to establish by decree the use and release procedures of the country's minimum-security reserves, including those held by CORES.

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 for each), and that no one country supplies more than 50% of Spain's gas needs. CORES' board also includes representatives from the gas sector and from the energy sector regulator, the Comisión Nacional de Energía.

Supportive regulatory framework

The Spanish state provides strong ongoing support for CORES in the form of a powerful regulatory framework that, in our opinion, bolsters the entity's credit profile, mainly in three ways:

- Ordinary fees. CORES' funding comes from the monthly fees it receives from its compulsory members (all oil and gas operators and importers in Spain, including large multinationals in the oil and gas sector, such as Repsol-YPF S.A. [BBB/Stable/A-2] and BP PLC [AA/Stable/A-1+]). By law, fees are set to cover all operating, financial, and administrative costs, including debt service. Fees are not substantial compared with the size of oil and gas operators' Spanish business, and, importantly, failure to pay the fees in a timely manner can result in the termination of an operator's license. The latter constitutes a very powerful incentive to comply with timely fee payments, which we see as a super senior obligation for oil and gas operators.
- Extraordinary fees. In the event of unforeseen circumstances that could put CORES' liquidity or solvency at risk, the government is entitled at any time--by law--to charge an extraordinary fee to the oil and gas operators. Only once in CORES' history has a member defaulted, and it was a minor operator.
- State financial support in potential stress scenarios. Spanish law does not preclude the state's granting of financial support to CORES in a potential stress scenario.

Legal status

We view CORES' legal status as 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--as demonstrated by the gradual increase in the level of strategic oil reserves that CORES must hold--the risks of a change in CORES' legal status and privatization are negligible in our opinion.

CORES is subject to supervision by the Spanish government under the tutelage of the Ministry of Industry. Due CORES' strategic importance for the Spanish state, its governing laws restrict its activities to those of a special-purpose entity with a clearly defined strategic role. For efficiency reasons, however, CORES is subject to private commercial laws and has a high degree of operational independence. Although the state is ultimately liable for CORES' obligations, only CORES' members financially support the entity's operations and debt repayment.

The Ministry of Industry nominates CORES' president for a five-year term. The government must also approve CORES' annual accounts and set the unit quotas (the amount of euros that each operator must pay per cubic meter of gas sold or consumed in the Spanish market) that will determine the fees paid by CORES' members and nonmembers. CORES' general assembly comprises CORES members. Voting rights are proportional to the annual quota paid by each member. The Ministry of Industry has a veto right. The board of directors encompasses the president and 11 members: Four are nominated by the Ministry of Industry, and seven by the general assembly (of the seven, five are operators in the oil sector, one in the gas sector, and one in the LPG sector). The president has a veto right over any agreement reached by the board that is contrary to existing laws.

Operations

Stockholding and storage operations

Spain holds minimum-security reserves for three different oil products: gasoline, middle distillates (diesel, kerosene, and jet fuel), and heavy fuel oils. CORES recalculates reserve requirements for each product category monthly and these basically correspond to the 92-day average of sales and consumption in the preceding calendar year.

CORES will have the right to fulfill its recent obligation to increase its oil reserves to ensure at least 45 days' worth of oil consumption through acquisitions in the open market and, for up to a maximum of 50% of total strategic reserves, through leasing contracts with oil operators. Currently, CORES has only two storage facilities of its own, which account for a minor share of its total stocks. It rents most of its stocking capacity from third parties. Investment in own oil stores will enable CORES to save on storage costs while increasing the currently limited storage capacity for Spain's oil market.

According to Spanish regulation, the leasing of stocks and renting of storage capacity must not alter prices or market conditions. In addition, CORES' members are obliged to sell and lease stocks and rent storage capacities as required by CORES.

Stock release procedures

CORES needs the government's authorization to release any strategic oil reserves if stock levels are below the legally required level. It must allocate any profits from oil product sales to a special reserve, and apply these funds to early debt amortization. Since its creation, CORES has never released stocks due to a disruption or crisis affecting oil supply or at its own discretion. We believe CORES will continue along these lines, despite the fact that its oil reserves already exceed the minimum legal requirements.

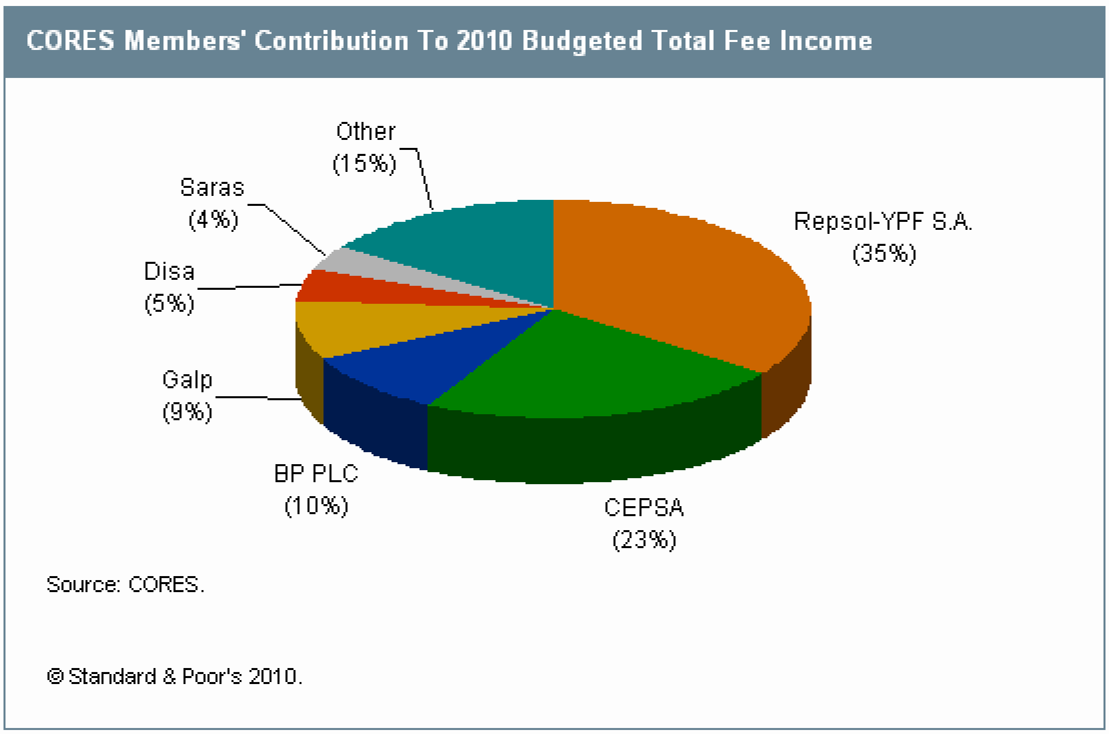
CORES finances its purchases of oil products through borrowed funds.

Membership And Fee System

Membership

In Spain, all oil operators authorized to distribute oil products and LPG, and, since 2004, all natural-gas operators, are legally obliged to be members of CORES (there are 100 members in total). Retail distributors and consumers of imported oil and gas products are obliged to pay monthly fees to CORES but do not have member status. 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

Spanish law requires fees to be calculated so as to cover all of CORES' costs: financial, operational, administrative, and those associated with allocation to a special statutory reserve (which, according to the current regulation, must eventually reach 25% of CORES' current expenditures). This full-cost pricing ensures CORES' financial viability, regardless of sharp cost increases. Owing to CORES' conservative budgeting, levied fees usually exceed the actual costs. The board of directors has the right to raise fees by up to a maximum of 5% in any given year, in order to adapt CORES' income stream to current circumstances. CORES maintains veto power over such decisions, however. The size of member fees does not represent a material expense for any single CORES member.

License termination for members that do not comply with fee payments

Member and nonmember fees, payable monthly without notice, are calculated based on a unit quota per volume of metric tons of a product sold or consumed in the preceding month by each member and nonmember. The calculation of these fees also factors in costs related to the maintenance of oil reserves by CORES on behalf of third parties. In the event of fee payment delays, CORES charges a penalty interest rate for the duration of the payment moratorium. By law, failure to settle the fee is a grave infraction, leading the Ministry of Industry to take action against the delinquent operator; such action could eventually result in the termination of the operator's license in the Spanish oil sector. Given this disincentive, we expect the rate of nonpayment to remain nil, or, at the most, negligible.

Extraordinary fees to avoid financial straits

The unit quotas are made official and legally binding by ministerial order in December or in 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 can impose an extraordinary fee on CORES' members and nonmembers. To date, no extraordinary fee has been necessary, given the conservative policy for setting unit quotas, which has resulted in annual fee surpluses since CORES began operations.

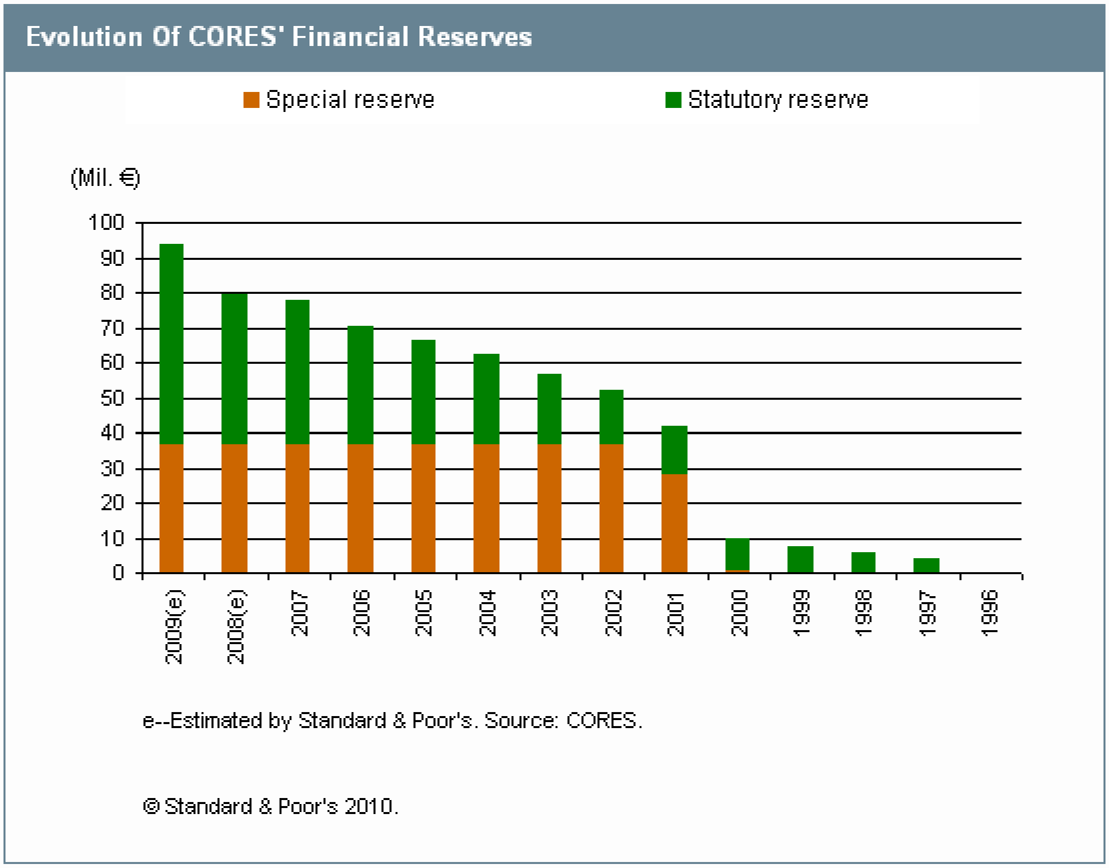
Excess fees

Given CORES' conservative budgeting, the entity tends to generate excess fees and net profits. Although members have never demanded that CORES return excess fees, the board of directors usually decides to do so as a signal of its willingness to contain fee levels.

Growing reserves

CORES' management devotes a material portion of net income to increasing the entity's net worth through a statutory reserve representing at least 25% of total budgeted expenditures in any given year. At year-end 2008, the statutory reserve totaled €42.7 million (see chart 2), and total net worth was €124.9 million (latest available data).

Chart 2



Provisions against member payment default and bankruptcies

Payment defaults have been immaterial since CORES' creation, and members have routinely complied with payment obligations. At year-end 2009, Standard & Poor's expects overdue fees to have been nil. Penalty charges for delayed payments are usually negligible, and such delays result mostly from minor administrative errors. CORES relies on Repsol-YPF and Cepsa (not rated), the two largest oil operators in Spain, for more than 60% of its annual fee income, although fees paid to CORES by the operators represent a minimal amount of their annual total expenses.

We deem that the concentration of CORES' fee income among a small number of operators does not pose a significant risk to its financial and funding profile. If an oil operator goes bankrupt, it ceases to operate in the market and competitors take over the failed operator's market share. Thus, we believe that any disruptions to CORES' revenue stream would likely be of short duration and would unlikely seriously hamper the entity's ability to carry out its operations. In any case, the Ministry of Industry can, if necessary, impose an extraordinary fee on members and nonmembers of CORES.

Finances

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Table 1

Corporación de Reservas Estratégicas de Productos Petrolíferos Profit And Loss							
	--Year ended Dec. 31--						
(Mil. €)	**2008**	**2007**	**2006**	**2005**	**2004**	**2003**	**2002**
Income	216.4	163.8	139.7	111.2	99.1	100.2	102.0
Membership fees	215.5	163.7	139.7	110.5	98.9	99.4	101.8
Financial income and other	0.9	0.1	0.0	0.7	0.1	0.8	0.2
Expenditures	201.7	162.3	131.7	107.7	94.9	94.2	97.7
Maintenance of stocks	121.8	103.6	95.0	84.7	75.9	72.4	70.2
Financial expenditures	75.4	54.3	33.0	19.0	15.9	19.2	24.8
Stocks and personnel	4.5	4.4	3.7	4.0	3.1	2.7	2.6
Corporate tax*	0	0	0	0	0	0	0
Net profit	14.7	1.6	7.9	3.5	4.3	5.9	4.3

*CORES is exempt from paying corporate tax.

Profit and loss account

CORES' largest operating expenditures are the maintenance and storage of its strategic stocks, which, at €145 million budgeted for 2010 (€132 million for 2009, according to CORES estimates), account for 73% of total operating costs (in line with CORES' track record, as shown in table 1 above). We expect these costs to gradually rise in the future, following the build-up of oil reserves (toward at least 45 days' worth in 2011). Also, financial expense (budgeted at €48.2 million for 2010), has increased gradually since CORES' creation (it reached just €16 million in 2004), reflecting the build-up of oil reserves through debt financing. Personnel and administrative costs, which CORES budgets at €4.6 million for 2010 (and estimates at €4.5 million in 2009) are more stable in nature and should, according to CORES, represent just 2.3% of 2010 total operating costs, continuing the historical trend (see table 2 below). On the whole, CORES' operating expenses persistently trend upward (we forecast compound annual growth of about 12% over the 2005-2010 period), owing to its mandate to increase the country's strategic oil stocks, which drives up maintenance and financial costs.

Table 2

Corporación de Reservas Estratégicas de Productos Petrolíferos Financial Ratios								
	--Year ended Dec. 31--							
(%)	**2008**	**2007**	**2006**	**2005**	**2004**	**2003**	**2002**	**2001**
Balance sheet								
Growth of assets	19.9	21.0	23.1	40.0	(0.3)	0.0	9.8	24.2
Growth of financial liabilities to banks and other creditors	19.9	21.0	23.2	40.0	(0.3)	0.0	10.1	24.0
Liquidity and reserves								
Reserves and retained earnings/liabilities	5.2	5.2	6.3	7.0	9.5	8.8	7.9	8.1
Market value of oil stocks/total debt (x)	1.2	2.2	1.6	2.0	1.7	1.3	1.5	N.A.
Cash plus short-term assets/interest payments	50.0	0.0	0.0	0.3	0.0	62.6	48.4	46.2
Cash plus short-term assets/total operating expenditures	19.0	0.0	0.0	0.0	0.0	12.7	12.3	13.6
Statutory reserve (in months of membership fees)	2.3	3.0	2.9	3.2	3.1	2.4	1.8	1.8
Profitability								
Return on assets (surplus/assets)	0.8	0.1	0.6	0.3	0.6	0.8	0.6	1.5
Surplus/revenues	6.8	1.0	5.9	3.2	4.3	5.9	4.3	10.4

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Table 2

Corporación de Reservas Estratégicas de Productos Petrolíferos Financial Ratios (cont.)								
Structure of revenues and expenditures								
Administrative costs/total expenditures	2.2	2.7	2.8	3.0	4.2	2.8	2.7	4.0
Interest payments/total expenditures	37.4	33.5	25.2	17.8	16.6	20.3	25.4	29.4
Storage costs/total expenditures	60.4	63.9	72.1	79.2	79.2	76.8	71.9	66.7
Membership fees/total revenues	99.6	99.9	101.1	100.0	98.5	99.2	100.8	91.8
Surplus brought forward/total revenues	6.8	1.0	5.7	3.2	4.3	5.9	4.3	10.4
Average cost of financial liabilities								
Interest payments/long-term liabilities	4.4	5.7	5.8	2.8	2.4	2.9	3.7	4.2

N.A.--Not available.

To redress its operating balance, CORES budgets member fees to match its operating costs. Thus, fee income, which CORES estimates at €166 million in 2009, is likely to have accounted for virtually 100% of its 2009 total operating income. Fee income budgeted for 2010 equals budgeted operating costs for the same year (€198 million).

Due to its conservative budgeting, CORES has always run a fee surplus, part of which it usually pays back to members and the remainder it allocates to the statutory reserve. In 2009, net profit (before the refund to members) reached a high of €31.6 million according to our estimates, owing to lower interest payments than initially budgeted. We understand that CORES will refund a large part of this net income to members after it makes its regular contribution to the statutory reserve. Over 2004-2009, average net profit after the refund was €5.3 million.

Balance sheet

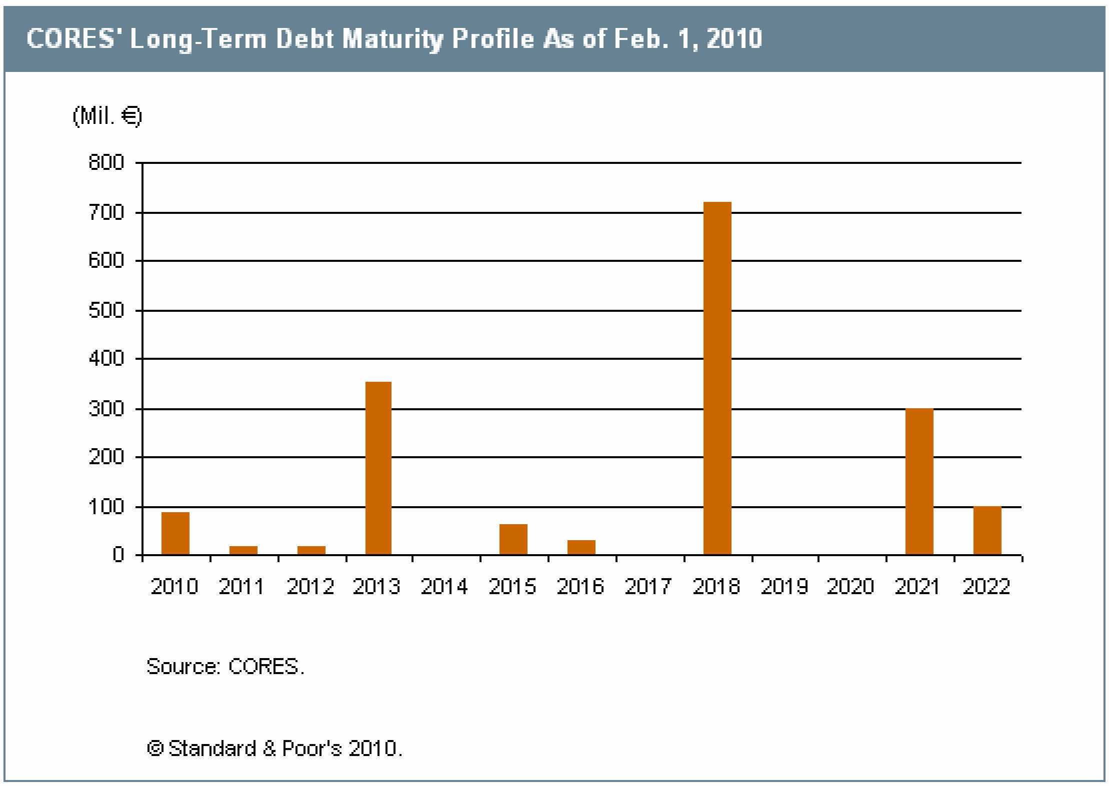
Table 3

Corporación de Reservas Estratégicas de Productos Petrolíferos Balance Sheet Statistics							
	--Year ended Dec. 31--						
(Mil. €)	**2008**	**2007**	**2006**	**2005**	**2004**	**2003**	**2002**
Assets							
Strategic reserves	1,785.5	1,552.1	1,282.6	1,048.7	756.7	755.3	755.5
Financial assets (short-term)	43.8	0.0	0.0	0.0	0.0	12.0	12.0
Tangible and intangible assets	48.5	45.1	37.5	23.0	9.1	0.8	0.4
Receivables	0.3	0.1	0.0	0.1	0.0	0.1	0.0
Cash	37.4	0.0	0.0	0.0	0.0	0.0	0.0
Total	1,915.5	1,597.3	1,320.1	1,071.9	765.9	768.2	767.9
Liabilities and equity							
Own funds	125.0	79.6	78.0	70.0	66.6	62.2	56.3
Of which special reserve	37.3	36.8	36.8	36.8	36.8	36.8	36.8
Of which statutory reserve	41.7	41.2	33.2	29.7	25.4	19.5	15.2

CORES' year-end 2009 strategic oil reserves, which it estimates at €2 billion, represented 96% of estimated total assets. Oil stocks are valued at their average acquisition cost. At year-end 2008, the market value of CORES' stocks was €2.1 billion, compared with an average acquisition cost of €1.8 billion. This constitutes a considerable unrealized capital gain. Nevertheless, it is unclear whether CORES would ever partly liquidate its strategic oil reserves, even in the event of financial distress.

CORES' long-term debt was €1.7 billion at year-end 2009, according to its estimates, similar to the year-end 2008 level (see table 3 above). We understand that CORES intends to place a €500 million bond to further build up its oil reserves. According to our estimates, CORES' debt should increase to about €2.2 billion in 2010. CORES' maturity profile (see chart 3) shows sizable repayments in 2013 and 2018. As the entity enlarges its debt burden, member fees will also rise. We believe that this increase would, however, continue to be immaterial for CORES' members, especially compared with the consequences of nonpayment (the loss of an operating license in the Spanish market).

Chart 3



CORES' Long-Term Debt Maturity Profile As of Feb. 1, 2010

Source: CORES.

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All of CORES' borrowings are denominated in euros. Reflecting the state support provided for in its legal framework, CORES has access to the Spanish financial markets on very favorable terms. It has limited need for short-term credit lines for operating purposes, because member fees are paid monthly. However, it has two committed credit lines from BBVA, for €250 million and €15 million, and another one from Crédit Agricole Corporate and Investment Bank (€250 million). We understand that CORES had borrowed a total of €270.5 million from these three lines as of Feb. 1, 2010.

CORES' special legal status prevents it from having capital, but the law obliges it to build up a financial reserve, which, by year-end 2009, CORES estimated at €94 million (including the special and statutory reserves).

Table 4

Corporación de Reservas Estratégicas de Productos Petrolíferos Financial Summary*

	--Fiscal year ended Dec. 31--				
(Mil. €)	**2008**	**2007**	**2006**	**2005**	**2004**
Rating history	AAA/Stable/A-1+	AAA/Stable/A-1+	AAA/Stable/A-1+	AAA/Stable/A-1+	AAA/Stable/A-1+

Table 4

Corporación de Reservas Estratégicas de Productos Petrolíferos Financial Summary* (cont.)					
Revenues	215.5	163.8	139.6	110.5	98.9
Net income from continuing operations	14.7	1.6	8.0	3.5	4.5
Funds from operations (FFO)	16.2	0.1	9.1	3.6	4.6
Capital expenditures	0.0	275.3	248.3	306.1	8.5
Debt	1,726.0	1,484.4	1,176.6	976.3	676.9
Equity	125.0	79.6	78.0	70.0	66.6
Operating income (before D&A)/revenues (%)	42.4	34.8	29.9	20.4	20.6
EBIT interest coverage (x)	1.2	1.0	1.2	1.2	1.3
EBITDA interest coverage (x)	1.2	1.1	1.3	1.2	1.3
Return on capital (%)	5.3	4.0	3.6	2.5	2.7
FFO/debt (%)	0.9	0.0	0.8	0.4	0.7
Debt/EBITDA (x)	18.9	26.0	28.2	43.3	33.3

*Fully adjusted. D&A--Depreciation and amortization.

Related Research

Enhanced Methodology And Assumptions For Rating Government-Related Entities, June 29, 2009

Ratings Detail (As Of March 10, 2010)*	
Corporacion de Reservas Estrategicas de Productos Petroliferos	
Issuer Credit Rating	AA+/Negative/A-1+
Senior Unsecured (3 Issues)	AA+
Issuer Credit Ratings History	
09-Dec-2009	AA+/Negative/A-1+
19-Jan-2009	AA+/Stable/A-1+
12-Jan-2009	AAA/Watch Neg/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 & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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