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Corporacion de Reservas Estrategicas de Productos Petroliferos

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Corporacion de Reservas Estrategicas de Productos Petroliferos

Major Rating Factors

Issuer Credit Rating
AA/Negative/A-1+

Strengths:

- "Almost certain" likelihood of timely and 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) reflects an equalization with the long-term rating on the Kingdom of Spain (AA/Negative/A-1+), since we believe 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.

The Kingdom of Spain fully owns CORES. We consider it to be a government-related entity (GRE). In accordance with our criteria for GREs, we base our rating approach on our view of CORES':

- "Integral" link with the Spanish government. We consider CORES to be an arm of the government as an agency tightly controlled and supervised by the Spanish Ministry of Industry, specifically mandated to build up, manage, and control the nation's strategic oil reserves, in accordance with the EU and international legislation. Although CORES does not receive funds from the government or benefit from any explicit guarantee on its liabilities, there is, in our view, strong government 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.
- "Critical" role as an entity especially 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 local and international financial markets to finance the purchase of oil stocks. Total debt on Dec. 31, 2010, stood at €1.87 billion. We understand CORES plans to issue an additional bond shortly.

Liquidity

CORES' liquidity position remains adequate, in our opinion, given that the agency takes into consideration all of the corporation's expenses, including debt service, when determining the annual fees applicable to its members. CORES' liquidity position also benefits from debt that is primarily long term (86% of the total as of year-end 2010) and from conservative budgeting where fees usually surpass expenditures. In addition, as of Feb. 2, 2011, CORES had committed credit lines of €0.62 billion, of which €0.37 billion available.

Outlook

The negative outlook on CORES reflects that on Spain, which in turn, reflects the possibility of a downgrade if Spain's fiscal position deviates materially, in our opinion, from the government's budgetary targets for 2011 and 2012. A downgrade of Spain, and consequently CORES, could also occur if the impending correction in private-sector leverage results in what we would consider to be a disorderly adjustment in the financial sector, leading to a sharper deterioration of the Spanish government's balance sheet or lower economic growth than we currently anticipate, possibly coupled with resurging deflationary pressures. Moreover, we could lower the ratings on Spain and on CORES if vulnerabilities persist related to external financing conditions or delays in the implementation of structural reforms.

Conversely, we could revise our outlook on Spain, and hence CORES, to stable if the government meets or exceeds its budgetary objectives in 2011 and 2012, risks to external financing conditions subside, and Spain's economic growth prospects prove to be more buoyant than we currently envisage as a result of a smooth economic adjustment and restructuring process.

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 CORES' 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 [A/Negative/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 and has never had the need to charge an extraordinary fee.
- 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 to 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 has 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.

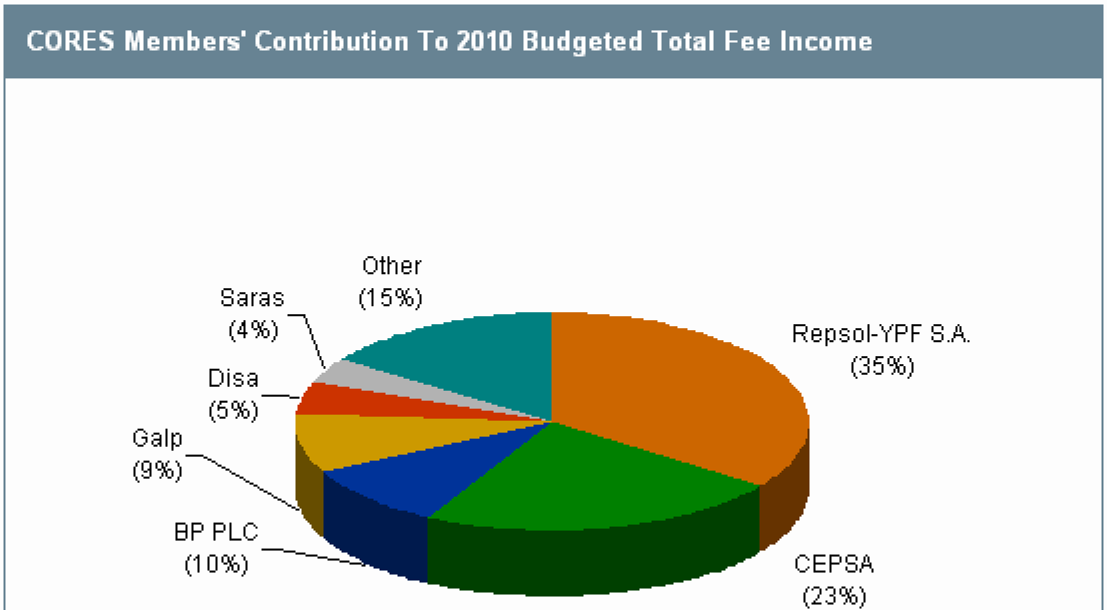
CORES finances its purchases of oil products through borrowed funds.

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 136 members in total, as of June 2009). Retail distributors and consumers of imported oil and gas products are obliged to pay monthly fees to CORES but do not have member status. Of total fee income for 2010, 85% will likely be concentrated in only six members, all of which are active the oil sector (see chart 1).

Chart 1



Source: Corporación de Reservas Estratégicas de Productos Petrolíferos (CORES).

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, which would lead the Ministry of Industry to take action against the delinquent operator. This 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.

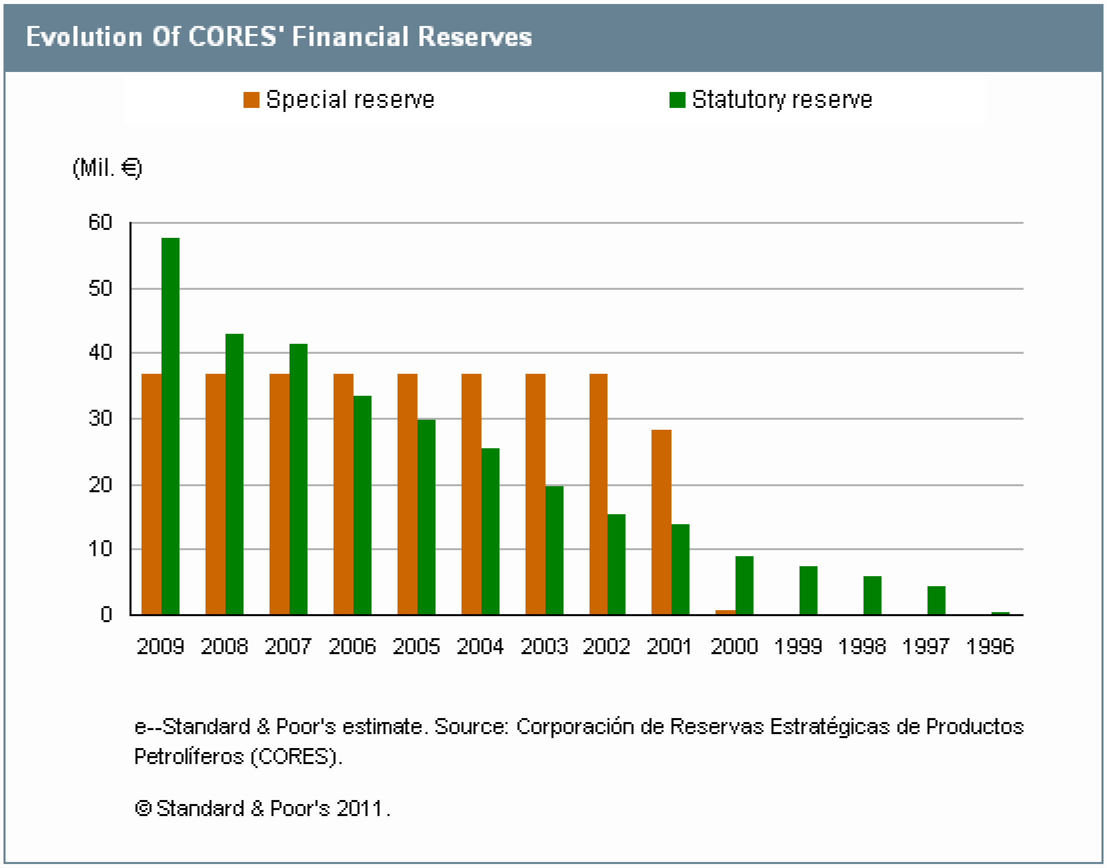
Excess fees

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, aimed at reaching at least 25% of total budgeted expenditures in any given year. As of June 30, 2010, and in line with year-end 2009 levels, CORES' reserves totaled €94 million, reflecting the increase in statutory reserves of €14.7 million in 2009 and special reserves that remained unchanged at €36.8 million (see chart 2). Accordingly total net worth increased to €157.9 million as of June 30, 2010, from €141.4 million at year-end 2009.

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. Penalty charges for delayed payments are usually negligible, and such delays result mostly from minor administrative errors. Approximately 85% of CORES annual fee is concentrated in six members (including the two largest oil operators in Spain: Repsol-YPF, representing 33%; and Cepsa (not rated) accounting for 22%).

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

Profit and loss account

CORES budgets its members fees to cover all of its operating and financial expenditures. As of year-end 2009, these fees reached €166 million and represented 99% of total operating income. This amount reflects a 22% decrease in CORES' budget, given a decline in demand. For 2010, CORES budgeted total fees of €198.2 million. As of June 30, 2010, operating revenue totaled €95.6 million. We believe that for the coming years, CORES will continue to rely, mainly, on members' fees to cover its expenditures. We also expect that, due to its conservative budgeting, CORES will continue to post operating surpluses that will serve to strengthen its statutory reserve. In 2009, net profit stood at €30 million (before allocations to the statutory reserve and the refund to members) and €24.6 million (after these two items) as of June 30, 2010. Average net profit after the refund was €5.3 million from 2004 to 2009 and might reach €16 million according to CORES' 2010 budget.

Table 1

Corporación de Reservas Estratégicas de Productos Petrolíferos Profit And Loss

	--Year ended Dec. 31--							
(Mil. €)	**2009**	**2008**	**2007**	**2006**	**2005**	**2004**	**2003**	**2002**
Income	167.3	216.4	163.8	139.7	111.2	99.1	100.2	102.0
Membership fees	166.1	215.5	163.7	139.7	110.5	98.9	99.4	101.8
Financial income and other	1.2	0.9	0.1	0.0	0.7	0.1	0.8	0.2
Expenditures	167.3	201.7	162.3	131.7	107.7	94.9	94.2	97.7
Maintenance of stocks	132.6	121.8	103.6	95.0	84.7	75.9	72.4	70.2
Financial expenditures	29.8	75.4	54.3	33.0	19.0	15.9	19.2	24.8
Stocks and personnel	4.6	4.5	4.4	3.7	4.0	3.1	2.7	2.6
Corporate tax*	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net profit	0.3	14.7	1.6	7.9	3.5	4.3	5.9	4.3

*CORES is exempt from paying corporate tax.

Historically, maintenance and storage have been CORES' largest expenditure. They represented 79% of total operating costs of €132 million in 2009, followed by financial expenditures, stock, and personnel (see table 1 above). We don't expect relevant changes in CORES' expenditure structure in the coming years, although financial expenditures might resume growth in the medium term, reflecting the build-up of oil reserves through debt financing. For 2010, we think maintenance and storage cost will likely reach €145.3 million (about 73% out of total expenditures), while financial expenditures should stand at €48.2 million or 24% out of total expenditures. Personnel and administrative costs, the most stable expenditures, are set to continue to represent less than 3% of total revenues.

Overall, we expect that CORES' operating expenses will likely continue to grow over the coming years, driven by permanent increases in maintenance and storage costs. We think financial expenditures, however, will likely remain in line with the average for the past three years. For 2010, financial expenses will likely total €48.2 million, according to CORES' budget.

Table 2

Corporación de Reservas Estratégicas de Productos Petrolíferos Financial Ratios

	--Year ended Dec. 31--							
(%)	**2009**	**2008**	**2007**	**2006**	**2005**	**2004**	**2003**	**2002**
Balance sheet								
Growth of assets	13.0	19.9	21.0	23.1	40.0	(0.3)	0.0	9.8
Growth of financial liabilities to banks and other creditors	13.0	19.9	21.0	23.2	40.0	(0.3)	0.0	10.1
Liquidity and reserves								
Reserves and retained earnings/liabilities	4.6	5.2	5.2	6.3	7.0	9.5	8.8	7.9

Table 2

Corporación de Reservas Estratégicas de Productos Petrolíferos Financial Ratios (cont.)								
Market value of oil stocks/total debt (x)	1.6	1.2	2.2	1.6	2.0	1.7	1.3	1.5
Cash plus short-term assets/interest payments	23.8	50.0	0.0	0.0	0.3	0.0	62.6	48.4
Cash plus short-term assets/total operating expenditures	4.2	19.0	0.0	0.0	0.0	0.0	12.7	12.3
Statutory reserve (in months of membership fees)	4.1	2.3	3.0	2.9	3.2	3.1	2.4	1.8
Profitability								
Return on assets (surplus/assets)	0	0.8	0.1	0.6	0.3	0.6	0.8	0.6
Surplus/revenues	0.2	6.8	1.0	5.9	3.2	4.3	5.9	4.3
Structure of revenues and expenditures								
Administrative costs/total expenditures	2.7	2.2	2.7	2.8	3.0	4.2	2.8	2.7
Interest payments/total expenditures	17.8	37.4	33.5	25.2	17.8	16.6	20.3	25.4
Storage costs/total expenditures	79.4	60.4	63.9	72.1	79.2	79.2	76.8	71.9
Membership fees/total revenues	99.3	99.6	99.9	101.1	100.0	98.5	99.2	100.8
Surplus brought forward/total revenues	0.2	6.8	1.0	5.7	3.2	4.3	5.9	4.3
Average cost of financial liabilities								
Interest payments/long-term liabilities	1.8	4.4	5.7	5.8	2.8	2.4	2.9	3.7

N.A.--Not available.

Balance sheet

Table 3

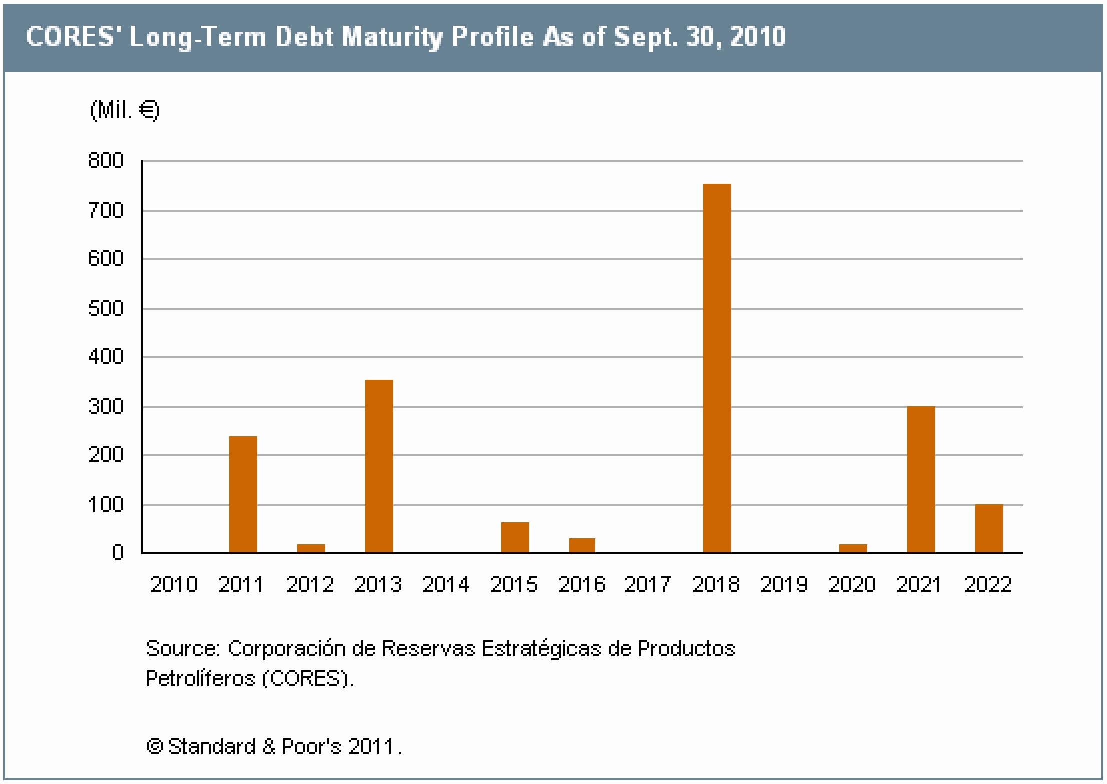
Corporación de Reservas Estratégicas de Productos Petrolíferos Balance Sheet Statistics								
	--Year ended Dec. 31--							
(Mil. €)	**2009**	**2008**	**2007**	**2006**	**2005**	**2004**	**2003**	**2002**
Assets								
Strategic reserves	2,045.5	1,785.5	1,552.1	1,282.6	1,048.7	756.7	755.3	755.5
Financial assets (short-term)	66.9	43.8	0.0	0.0	0.0	0.0	12.0	12.0
Tangible and intangible assets	46.5	48.5	45.1	37.5	23.0	9.1	0.8	0.4
Receivables	3.1	0.3	0.1	0.0	0.1	0.0	0.1	0.0
Cash	4.0	37.4	0.0	0.0	0.0	0.0	0.0	0.0
Total	2,165.9	1,915.5	1,597.3	1,320.1	1,071.9	765.9	768.2	767.9
Liabilities and equity								
Own funds	141.3	125.0	79.6	78.0	70.0	66.6	62.2	56.3
Of which special reserve	36.8	37.3	36.8	36.8	36.8	36.8	36.8	36.8
Of which statutory reserve	57.5	41.7	41.2	33.2	29.7	25.4	19.5	15.2

CORES' strategic oil reserves, accounted for an average of 96% of total assets over the past five years, measured at their average acquisition cost. In 2009, these reserves reached €2 billion and remained at this level as of June 30, 2010. Toward year-end, reserves might increase to €2.2 billion, according to budget. The rest of CORES' assets are made up of financial assets and tangible and intangible assets.

CORES' long-term debt of €1.6 billion as of June 30, 2010, reflects a minor increase against the year-end 2009 figure. Short-term debt of €0.3 billion, contracted in 2009, remained unchanged on the same date. In the short term, CORES will likely issue an additional €500 million bond to further build up its oil reserves and refinance part of its short-term debt.

CORES' long-term debt maturity profile shows sizable repayments in 2013 and 2018 (see chart 3). We expect that CORES will likely either appropriately take into consideration these expenditures in its budgeted fees, or refinance them.

Chart 3



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. On Feb. 2, 2011, CORES had committed credit lines of €0.62 billion, of which €0.37 billion available.

CORES' special legal status prevents it from having capital. However, the law obliges it to build up a financial reserve, which, as of June 30, 2010, totaled €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. €)	**2009**	**2008**	**2007**	**2006**	**2005**	**2004**
Rating history	AA+/Negative/A-1+	AAA/Stable/A-1+	AAA/Stable/A-1+	AAA/Stable/A-1+	AAA/Stable/A-1+	AAA/Stable/A-1+
Revenues	166.1	215.5	163.8	139.6	110.5	98.9
Net income from continuing operations	0.3	14.7	1.6	8.0	3.5	4.5

Table 4

Corporación de Reservas Estratégicas de Productos Petrolíferos Financial Summary* (cont.)						
Funds from operations (FFO)	2	16.2	0.1	9.1	3.6	4.6
Capital expenditures	260	0.0	275.3	248.3	306.1	8.5
Debt	1,977.4	1,726.0	1,484.4	1,176.6	976.3	676.9
Equity	141.3	125.0	79.6	78.0	70.0	66.6
Operating income (before D&A)/revenues (%)	19.1	42.4	34.8	29.9	20.4	20.6
EBIT interest coverage (x)	1.0	1.2	1.0	1.2	1.2	1.3
EBITDA interest coverage (x)	1.1	1.2	1.1	1.3	1.2	1.3
Return on capital (%)	0	5.3	4.0	3.6	2.5	2.7
FFO/debt (%)	0.1	0.9	0.0	0.8	0.4	0.7
Debt/EBITDA (x)	61.7	18.9	26.0	28.2	43.3	33.3

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

Related Criteria And Research

Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010

Ratings Detail (As Of February 4, 2011)*	
Corporacion de Reservas Estrategicas de Productos Petroliferos	
Issuer Credit Rating	AA/Negative/A-1+
Senior Unsecured (4 Issues)	AA
Issuer Credit Ratings History	
28-Apr-2010	AA/Negative/A-1+
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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