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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
BBB-/Negative/A-3

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 rating on Corporacion de Reservas Estrategicas de Productos Petroliferos (CORES) reflects an equalization with the long-term rating on the Kingdom of Spain (BBB-/Negative/A-3). We consider CORES to be a government-related entity (GRE). In accordance with our criteria for rating GREs we believe there is an "almost certain" likelihood that the Spanish government would provide timely and sufficient extraordinary support to CORES in the event of financial distress.

CORES is a corporation governed by public law, but with a distinct legal status and acting under private law. It conducts its activities under the tutelage of the central government, exercised through the Ministry of Industry, Energy, and Tourism ("the Ministry").

Our opinion of an almost certain likelihood of support reflects 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, Energy and Tourism. 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 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 see as 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. We believe 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 would, in our opinion, be able to undertake CORES' mandate.

CORES borrows from local and international financial markets to finance the purchase of oil stocks. Its total debt was €1.9 billion on Dec. 31, 2011.

Liquidity

CORES' liquidity is "adequate", as defined in our criteria, given that CORES takes into consideration all of its expenses, including debt service, when determining the annual fees applicable to its members. These fees are typically set with very conservative assumptions about expected expenditures. As a result CORES normally returns excess fees to operators at year end, although it could retain excess fees as reserves if necessary. Fees are cashed in monthly, ensuring regular access to liquidity inflows.

CORES' long-term debt accounts for 86% of its total debt. As of Oct. 5, 2012, CORES had credit lines of €305 million, of which €51 million were available. CORES faces debt repayments of €599 million in 2013--€350 million from long-term debt, and €249.5 million from the renewal of credit lines.

We understand that CORES has already refinanced its credit lines, which expire in February 2013, using a combination of sources including bank loans, new credit lines, and the sale of excess oil reserves for €70.5 million. We expect that CORES will fund its €350 million long-term debt maturity, which is due in July, by issuing debt in the capital markets, or signing loans with the banking sector.

CORES may also choose to meet part of its remaining financing needs for the year 2013 by selling additional excess reserves. A drop in petroleum product consumption due to the economic crisis in Spain has left CORES' holding reserves above the legally established limits. Based on current prices, CORES

estimates it could receive up to €520 million from the sale of these reserves, for which there is a liquid market. CORES can choose how much of the excess to sell and would be legally obliged to use any proceeds from sales to reduce its indebtedness.

Finally, in our view CORES may also decide to set higher fees for its members for the year 2013 to cover all or part of its long-term debt maturities, although we consider it unlikely that CORES would have to resort to this option.

Outlook

The "negative" outlook on CORES primarily reflects that on Spain. A downgrade of the sovereign would also result in a downgrade of CORES.

We might also lower the rating if, contrary to our current expectation, CORES was not able to access funding smoothly through a combination of bank loans or bonds, sale of oil reserves or higher fees to its members, or ultimately the support of the Spanish government.

We believe it is unlikely that the combination of all these alternative sources of funding would prove insufficient to meet CORES' financing needs for 2013.

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 different groups of oil products. Spain has set these minimums at 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.

CORES must, by national law (which follows EU regulation), maintain at any given time a stock of at least 42 days' worth of national oil product consumption. 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 (BBB-/Stable/A-3) and BP (A/Positive/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. No operator has seen its license terminated to date due to a failure to pay CORES' fees.
- 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. This has never happened to date.
- 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. According to its legal status, which can only be changed through parliamentary approval, it can neither be privatized nor go bankrupt. 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, exercised through the Ministry. 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 we believe the state would ultimately support CORES in meeting its obligations if necessary, only CORES' members financially support the entity's operations and debt repayment.

The Ministry nominates CORES' president for a five-year term. On Feb. 16, 2012, Mr. Pedro Miras Salamanca was nominated by the Spanish Minister of Industry as CORES' new president. The government sets 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 has a veto right. The board of directors encompasses the president and 11 members: Four are nominated by the Ministry, 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 minister of Industry, acting through CORES' 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 groups of 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 obligation to increase its oil reserves to ensure at least 42 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.

According to Spanish regulation, the leasing of stocks and renting of storage capacity must not alter prices or market conditions.

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 debt amortization. In 2010, CORES sold stocks due to the termination of a storage contract, obtaining a profit of €49.5 million which was entirely allocated to reserves.

In 2011, the Spanish government took part in a coordinated international effort to contain pressures on oil prices arising from the Libyan crisis. The central government required the release of stocks for an amount equivalent to 2.3 days of reserves. The reduction was carried out exclusively from reserves held by market operators, which saw a corresponding temporary reduction in their reserve requirements. This reserve release had no impact on CORES, which did not participate directly.

Conversely, CORES may sell any excess reserves over its legal requirement. We understand CORES sold 120,000 cubic meters worth of reserves on Oct. 16, 2012, for €70.5 million. After this transaction, CORES' reserves were still about 12% higher than required. CORES could therefore sell these reserves to market operators. At current prices, market value of these excess reserves is close to €520 million.

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 243 members in total, as of December 2011). Retail distributors and consumers of imported oil and gas products must pay monthly fees to CORES but do not have member status. Of total fee income for 2011, about 84% was concentrated in only six members, all of which are active in the oil sector.

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). Fees are set in proportion to the days of strategic reserves held by CORES. 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. The size of its 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 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 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. As a result of this policy, during 2011 CORES returned €13.4 million in excess fees to its members. However, we consider that CORES could decide to retain these fees in the future in order to boost its reserves.

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 year-end 2011, CORES' reserves totaled €144.4 million.

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 84% of CORES annual fee is concentrated in six members (including the two largest oil operators in Spain: Repsol, representing 32%; and Cepsa (not rated) accounting for 21%).

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 went bankrupt, competitors would 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 not seriously hamper the entity's ability to carry out its operations. In any case, the Ministry could, if necessary, impose an extraordinary fee on CORES' members.

Finances

Profit and loss account

CORES budgets its member fees to cover all of its operating and financial expenditures. As of year-end 2011, fees reached €184.7 million. Operating surplus was €31.2 million. We expect that, due to its conservative budgeting, CORES will continue to post slight operating surpluses. CORES returned approximately €13.4 million to its members, leading to a final result of €0.2 million in profits

Table 1

CORES Profit And Loss

(Mil. €)	2011	2010	2009
Revenues	184.9	218	167.3
Fee income	184.7	168.2	166.1
Net sales	0	49.5	0
Financial income and others	0.2	0.3	1.2
Expenses	184.7	168.2	167
Reserve Maintenance	148	143.9	132.6
Financial costs	31.1	19.7	29.8
Structural costs	5.6	4.6	4.6
Profit/Loss	0.2	49.8	0.3

Source: CORES.

Maintenance and storage are CORES' largest expenditure. They represented over 80% of total operating costs. We don't expect relevant changes in CORES' expenditure structure in the coming years.

Overall, we anticipate 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 2012, financial expenses were conservatively budgeted at €49.9 million, although actual expenditures, based on previous years' experience, are more likely to be about €19.5 million.

Balance sheet

Table 2

CORES Balance Sheet

(Mil. €)	2011	2010	2009
Assets	2158.6	2119.9	2165.9
Strategic Reserves	2025.2	2014.5	2045.5
Fixed Assets and other	132.9	105.4	120.4

Table 2

CORES Balance Sheet (cont.)			
Liabilities	2158.6	2119.9	2165.9
Equity	144.6	94.6	94.3
Net income	0.2	49.8	0.3
Long term debt	1634.2	1626.2	1626.2
Short term debt	273.4	289.1	378.3
Others	106.2	60.2	66.8

Source: CORES.

CORES' strategic oil reserves accounted for an average of 96% of total assets over the past five years, measured at their average acquisition cost. The book value of these reserves has remained stable, at €2 billion, in 2009, 2010 and 2011. The rest of CORES' assets are made up of financial assets and tangible and intangible assets.

CORES' long-term debt of €1.63 billion at year-end 2011 remains mostly stable compared with 2009 and 2010. Short-term debt of €0.3 billion, contracted in 2009, remained unchanged on the same date.

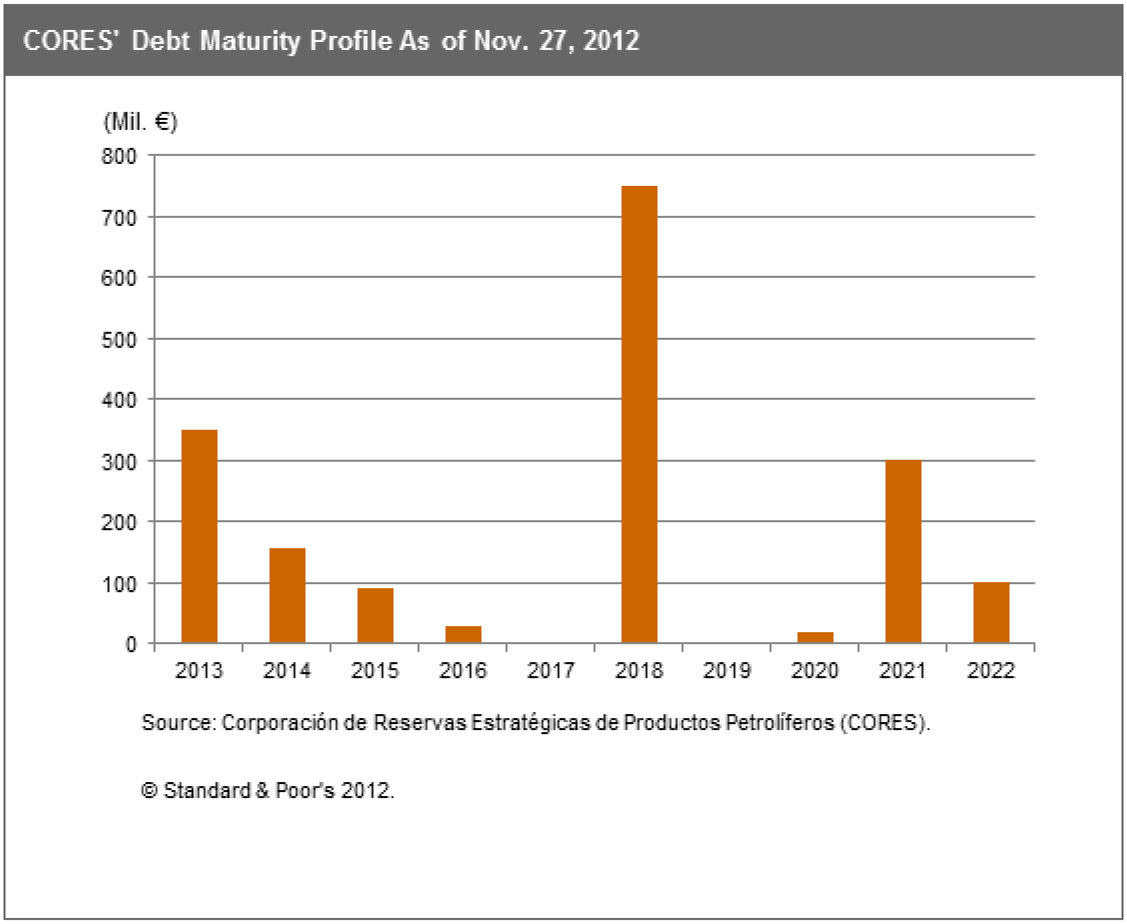
CORES' special legal status prevents it from having capital. However, the law requires it to build up a financial reserve, which, on Dec. 31, 2011, totalled €144 million (including the special and statutory reserves).

CORES' debt maturity profile shows sizable repayments in 2013 (€350 million long term debt) and 2018 (€750 million) (see chart 3).

We understand that CORES has already refinanced its credit lines, which expire in February 2013, using a combination of sources including bank loans, new credit lines, and the sale of excess oil reserves for €70.5 million. We expect that CORES will fund its €350 million long-term debt maturity, which is due in July 2013, by issuing debt in the capital markets, or signing loans with the banking sector. We also expect CORES to break down the refinancing in several, smaller loans or bonds with different maturities, in order to even out the debt repayment schedule over the coming years.

After 2013, CORES will see four years of minimal debt service, which we expect the entity will use to prepare for the 2018 maturities well in advance.

Chart 1



CORES may also choose to meet part of its remaining financing needs for the year 2013 by selling additional excess reserves. A drop in petroleum product consumption due to the economic crisis in Spain has left CORES' holding reserves above the legally established limits. Based on current prices, CORES estimates it could receive up to €520 million from the sale of these reserves, for which there is a liquid market. CORES can choose how much of the excess to sell and would be legally obliged to use any proceeds from sales to reduce its indebtedness.

At current market prices and consumption levels, the sale of CORES' excess reserves would more than cover its July 2013 repayment. However, the margin of maneuver of CORES in this regard might be reduced by two factors (or a combination of both):

- A decrease in oil prices, which would reduce the valuation of its excess reserves; and
- An increase in oil consumption, which would increase the required physical units to be kept as reserves, and therefore reduce CORES' excess reserves available to be sold.

Based on our calculations, we estimate that the value of CORES' reserves is relatively robust with regards to oil prices. We consider that excess reserves would be sufficient to cover debt service in July up to a maximum decrease in oil prices of 32.7%.

However, the reserve sale option would be eroded by increases in consumption. According to our estimates, excess reserve sales would be sufficient to meet July 2013 debt service if consumption increased by a maximum of 5.2%. Excess reserves would disappear completely with an increase in consumption of about 12%

Table 3

Sensitivity Analysis Of CORES' Potential Reserve Sales

Sensitivity Scenarios	Current (October 2012)	Sensitivity scenario 1: Oil price decrease, consumption constant	Sensitivity scenario 2: increase in consumption, oil price constant	Sensitivity scenario 3: increase in consumption, oil price constant, zero valuation of excess reserves.
Consumption levels used to calculate required reserves (cubic meters)	47,337,491	47,337,491	49,801,921	53,092,129
Required reserves	6,067,538	6,067,538	6,339,831	6,805,146
Existing reserves	6,805,146	6,805,146	6,805,146	6,805,146
Excess reserves (cubic meters)	819,564	819,564	517,016	--
Valuation of current excess reserves € M	520	350	350	--
Implicit price per cubic meter (€)	634	427	634	Not relevant
Implications of scenarios		Maximum acceptable oil price decrease: -32.7%	Maximum acceptable increase in oil product consumption vs. : 5.2%	Implicit growth in consumption that would eliminate excess reserves: 12.2%

Source: Standard & Poor's estimates, based on CORES data Note: Excess reserves are calculated as the difference between existing reserves and required reserves, + 10%.

Based on current market trends, we consider it unlikely that either scenario will materialize before CORES has to refinance its July 2013 maturity.

If this was the case, in our view CORES could also decide to set higher fees for its members for the year 2013 to cover all or part of its long-term debt maturities, although we consider it unlikely that CORES would have to resort to this option.

Related Criteria And Research

- Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010
- Spain's Corporacion de Reservas Estrategicas de Productos Petroliferos Downgraded To 'A/A-1' Following Action On Spain, Jan. 17, 2012
- Spain's Ratings Lowered To 'A/A-1'; Outlook Negative, Jan. 13, 2012

Ratings Detail (As Of November 28, 2012)	
Corporacion de Reservas Estrategicas de Productos Petroliferos	
Issuer Credit Rating	BBB-/Negative/A-3
Senior Unsecured	BBB-
Issuer Credit Ratings History	
16-Oct-2012	BBB-/Negative/A-3
30-Apr-2012	BBB+/Negative/A-2

Ratings Detail (As Of November 28, 2012) (cont.)	
17-Jan-2012	A/Negative/A-1
07-Dec-2011	AA-/Watch Neg/A-1+
13-Oct-2011	AA-/Negative/A-1+
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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