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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, and financial flexibility as a result of excess reserves available for sale.

Weaknesses:

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

Rationale

Standard & Poor's Ratings Services equalizes its long-term rating on Corporacion de Reservas Estrategicas de Productos Petroliferos (CORES) 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, through the Ministry of Industry, Energy, and Tourism, and therefore we consider it to be a GRE. Our opinion of an almost certain likelihood of government 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. Moreover, the current legal framework allows the government to demand extraordinary fees from operators if necessary. Ultimately, we believe if CORES was dissolved, the central government would take over its obligations.
- "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 €1.8 billion as of July 31, 2013.

Liquidity

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

In 2013, CORES faced a demanding debt repayment schedule totaling €599 million. It successfully refinanced these maturities through bank loans, new credit lines, the sale of excess reserves, and the issuance of a €350 million three-year bond.

Post this refinancing, CORES has maturities of only €161 million in 2014 and €92 million in 2015. We do not currently expect CORES to have any difficulties in raising funds to refinance these maturities.

In the longer term, CORES will have to refinance €380 million in 2016 and €750 million in 2018. We expect CORES to start prefinancing these maturities well ahead of time, and to gradually smooth its maturity profile.

In case of need, CORES may also resort to the sale of excess reserves to meet its financing needs. A drop in petroleum product consumption due to the recession in Spain has left CORES holding reserves above the legally established limits (which are set in days of consumption). As of Aug. 31, 2013, CORES held reserves which were 22% higher than legally required. We estimate CORES could receive up to €802 million for the sale of these reserves, for which there is a liquid market. This amount would be sufficient to meet CORES' financial maturities from 2014 to the end of 2016. Nevertheless, the value of excess reserves is subject to fluctuations arising from potential changes in consumption levels and global prices for petroleum products.

CORES may also request that the ministry levy extraordinary fees to its members if needed to cover all or part of its long-term debt maturities. However, we consider it unlikely that CORES would have to resort to this option.

Outlook

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

GRE Methodology Impact: Almost Certain Likelihood Of Extraordinary Support

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 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.

Critical role for the government, as manager of Spain's strategic 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.

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.

As a member of the International Energy Agency and the EU, Spain must maintain minimum stocks for different groups of oil products. 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.

CORES must, by national law (which in turn 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.

Integral link with the Spanish government

CORES is subject to supervision by the Spanish government, exercized through the Ministry of Industry, Energy, and Tourism. 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 liquefied petroleum gas [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.

Strong Ongoing Support Through A Supportive Funding Framework, Anchored In A Strong Legal Status

According to CORES' legal status, which can only be changed through parliamentary approval, it can neither be privatized nor go bankrupt. Given the entity's strategic role, the risks of a change in CORES' legal status and privatization are negligible in our opinion.

The Spanish state provides strong ongoing support for CORES in the form of a regulatory framework, whose features, in our opinion, bolster the entity's credit profile.

Compulsory 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. Retail distributors and consumers of imported oil and gas products must pay monthly fees to CORES but do not have member status. Approximately 84% of CORES annual fees in 2012 were concentrated in six members (including the two largest oil operators in Spain: Repsol S.A., representing 32%; and Cepsa (not rated) accounting for 21%).

Fee setting policy helps to ensure sufficiency of revenues

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 and BP PLC. Member and nonmember fees, payable monthly without notice, are calculated based on a unit quota per volume of cubic meter tons of a product sold or consumed in the preceding month by each member and nonmember. By law, fees are set to cover all operating, financial, and administrative costs, including debt service. The calculation of these fees also factors in costs related to the maintenance of oil reserves by CORES on behalf of third parties. This full-cost pricing ensures CORES' financial viability, regardless of sharp cost increases.

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 board of directors has the right to raise fees by up to a maximum of 5% in any given year. Should this not suffice, the Ministry government is entitled at any time--by law--to authorize an extraordinary fee to the oil and gas operators. To date, no extraordinary fee has ever been necessary, given the conservative policy for setting unit quotas, which has resulted in annual fee surpluses since CORES began operations.

Strong incentives for timely payment

Fees are not substantial compared with the size of oil and gas operators' Spanish business. 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, eventually leading to the termination of the operator's license in the Spanish oil sector. 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.

Given this disincentive, payment defaults have been immaterial since CORES' creation, and members have routinely complied with payment obligations. We expect the rate of nonpayment to remain nil, or, at the most, negligible in the future. Delays in payments have mostly resulted from minor administrative errors, and the relevant operator has seen its license terminated due to its failure to pay CORES' fees. Penalty charges for delayed payments are usually negligible.

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.

Excess fees

Given its conservative budgeting, CORES tends to generate excess fees. Although members have never demanded that CORES return excess fees, the board of directors has decided in recent years to do so as a signal of its willingness to contain fee levels.

We think CORES will take a different approach to excess fees in 2013. It has accumulated excess fees of about €11 million as of July 2013, which could reach about €20 million by year-end, in the absence of any change. Instead of returning 2013 excess fees in 2014, CORES lowered fees to its members, effective from October 2013.

Strategic Reserve Management And Release Procedures

Storage

Spain holds minimum-security reserves for three different groups of oil products: gasoline, middle distillates (diesel, kerosene, and jet fuel), and heavy fuel oils, as well as crude oil. 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 may fulfill its obligation to maintain 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. CORES' reserves are distributed across the Spanish territory, broadly in line with consumption patterns. Crude oil reserves, which represent about 30% of the total, are kept at Spain's largest refineries, ready to be transformed into finished products at short notice in the event of a disruption of supply.

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. 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. As of Aug. 31, 2013, CORES held reserves which were 22% higher than legally required. We estimate CORES could receive up to €802 million for the sale of these reserves, for which there is a liquid market.

Financial profile

Profit and loss account

CORES budgets its member fees to cover all of its operating and financial expenditures. As of year-end 2012, fees reached €180.4 million, and operating revenues were €224 million, due to the sale of oil reserves for about €70.5 million. As a result of this extraordinary item, the operating surplus was €44.4 million. We expect that, due to its conservative budgeting, CORES will continue to post operating surpluses. Maintenance and storage are CORES' largest expenditure, reaching €154 million as of year-end 2012. We don't expect relevant changes in CORES' expenditure structure in the coming years.

Overall, we anticipate that CORES' operating expenses may decrease slightly over the coming years, as CORES' long term storage contracts, which included automatic cost increases gradually expire, starting in 2014. We expect CORES may renegotiate these contracts at more favorable market conditions. Nevertheless, if this is the case, CORES will only gradually feel the impact on its accounts, which in turn will result in a corresponding downward adjustment of member fees.

We think financial expenditures, however, will likely remain in line with the average for the past three years. For 2012, financial expenses were budgeted at €49.9 million, although actual expenditures were finally €20.9 million, in line with our estimate of €19.5 million. We expect CORES will continue to budget its financial expenditures conservatively.

Table 1

CORES Profit And Loss Statement				
(Mil. €)	**2012**	**2011**	**2010**	**2009**
Revenues	224.9	184.9	218	167.3

Table 1

CORES Profit And Loss Statement (cont.)				
Fee income	180.4	184.7	168.2	166.1
Net sales	44.1	0	49.5	0
Financial income and others	0.4	0.2	0.3	1.2
Expenses	180.4	184.7	168.2	167
Reserve maintenance	153.9	148	143.9	132.6
Financial costs	20.9	31.1	19.7	29.8
Structural costs	5.6	5.6	4.6	4.6
Profit/loss	44.4	0.2	49.8	0.3

Source: CORES.

Balance sheet

CORES' strategic oil reserves account for about 93% of total assets as of year-end 2012. Reserves are valued at their average acquisition cost, which at about $30 dollars per barrel of oil is significantly below current market values. The book value of these reserves is about €2 billion, and remains stable over time. The rest of CORES' assets are made up of financial assets, mainly derivatives, and tangible 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.

Table 2

CORES Balance Sheet

(Mil. €)	2012	2011	2010	2009
Assets	2,140.1	2,158.6	2,119.9	2,165.9
Strategic reserves	1,996.3	2,025.2	2,014.5	2,045.5
Fixed assets and other	143.8	132.9	105.4	120.4
Liabilities	2,140.1	2,158.6	2,119.9	2,165.9
Equity	189.0	144.6	94.6	94.3
Net income	44.4	0.2	49.8	0.3
Long term debt	1,446.2	1,634.2	1,626.2	1,626.2
Short term debt	370.2	273.4	289.1	378.3
Other	90.3	106.2	60.2	66.8

Source: CORES.

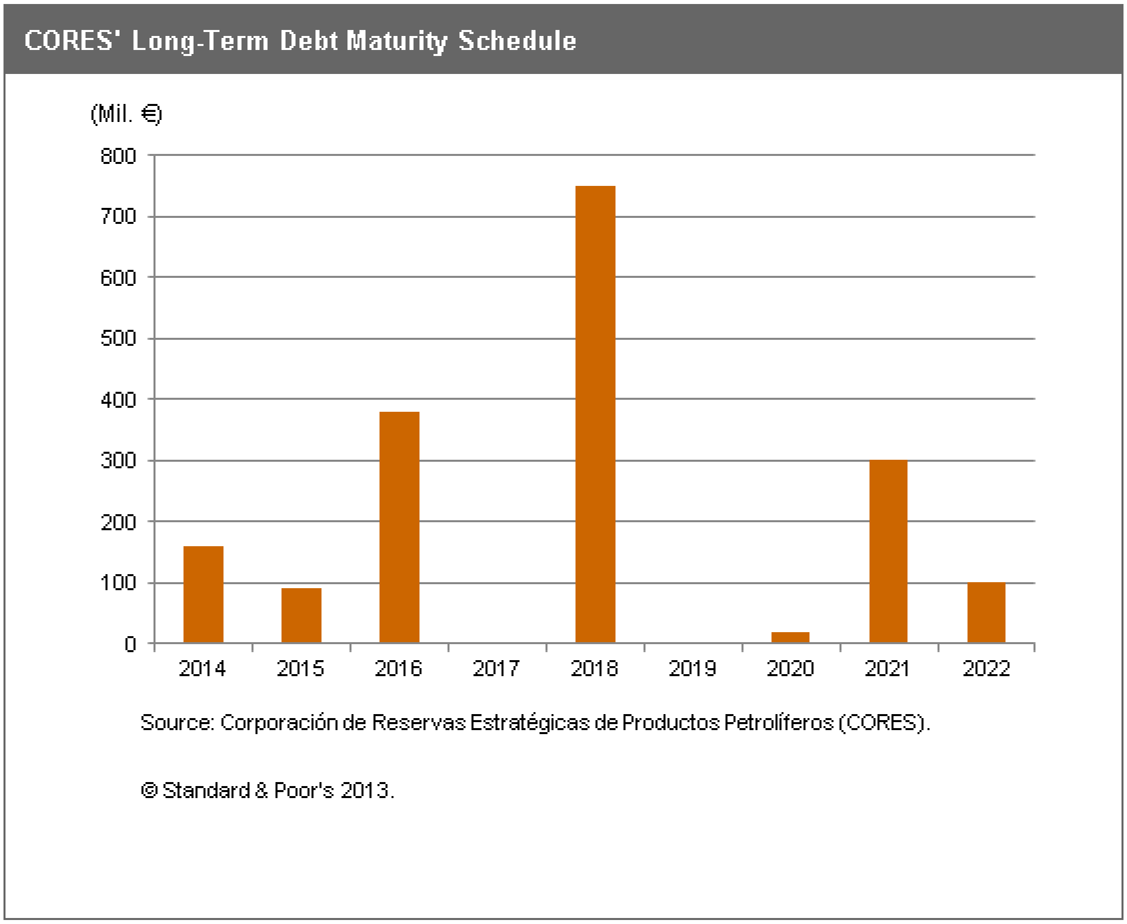
CORES' special legal status prevents it from having capital. However, the law requires it to build up a financial reserve, which, on Dec. 31, 2012, totaled €144 million (including the special and statutory reserves). The extraordinary income derived from the 2012 oil reserve sale was allocated to reserves. As of end-July 2013, CORES' reserves had already reached €189 million.

Debt service and funding strategy

CORES refinanced its July 2013 bond maturity by issuing a new three-year, €350 million bond. The bond registered ample excess demand. Spanish investors covered 43% of the bond, but the remainder was distributed among investors from the major Western European countries and the Nordics.

Following this issuance, CORES now faces much lower funding needs for 2014 and 2015, with only €161 million and €92 million in long term maturities respectively. CORES will have to refinance again its €350 million maturity in 2016, and will face a €750 million maturity in 2018 (see chart 1).

Chart 1



We expect CORES to issue debt during 2014 or 2015 to prefinance its 2016 maturities, and to start smoothing its maturity profile over time.

While we think CORES will continue seeking market financing, it could also meet its financing requirements through the sale of excess reserves, if this became necessary.

A drop in petroleum product consumption due to the recession in Spain has left CORES' holding reserves above the legally established limits. Based on current prices, CORES estimates it could receive up to €802 million from the sale of these excess reserves, for which there is a liquid market (see table 3). 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 combined long-term debt maturities for the following three years, or more than four times its 2014 maturities.

However, the margin of maneuver of CORES in this regard might be reduced by two factors (or a combination of both):

- A decrease in petroleum product prices, which would reduce the valuation of its excess reserves; and
- An increase in Spanish petroleum product 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 regard to oil prices. We consider that excess reserves would be sufficient to cover debt maturities in 2014 up to a maximum decrease in oil prices of 80%, which we consider extremely unlikely.

However, the reserve sale option could also be eroded by increases in consumption, which would narrow the excess reserves. According to our estimates, excess reserve sales would be sufficient to meet 2014 debt maturities if consumption increased by a maximum of 17% (assuming constant petroleum product prices). Excess reserves would disappear completely with an increase in consumption of about 22%. Current economic conditions in Spain also make this scenario very unlikely, in our opinion.

Table 3

Valuation of CORES' Excess Reserves And Sensitivity Analysis

	Valuation of excess reserves			**Sensitivity analysis based on August 2013 reserves: Ability to meet 2014 debt maturities entirely through reserve sales**					
				Scenario 1 (SC1)		**Scenario 2 (SC2)**		**Scenario 3 (SC3)**	
	October 2012	**August 2013**	**% change 2013 versus 2012**	**Petroleum product price decrease, constant consumption**	**SC1 versus 2013, % change**	**Consumption increase, petroleum product price constant**	**SC2 versus 2013, % change**	**Increase in consumption, no excess reserves**	**SC3 versus 2013, % change**
Estimated yearly consumption ('000 cubic meter)	47,337	44,517	(6)	44,517	0	51,981	17	54,123	22
Required reserves ('000 cubic meter)	6,068	5,600	(8)	5,600	0	6,539	17	6,808	22
Existing reserves ('000 cubic meter)	6,817	6,808	(0)	6,808	0	6,808	0	6,808	0
Excess reserves ('000 m3) - regulatory definition *	750	1,208	61	1,208	0	242	(80)	0	--
Excess reserves ('000 cubic meter), available for sale *	833	1,343	61	1,343	0	270	(80)	0	--
Valuation of excess reserves available for sale (mil. €)	528	802	52	161	(80)	161	(80)	0	--

Table 3

Valuation of CORES' Excess Reserves And Sensitivity Analysis (cont.)									
Implicit price per cubic meter (€)	634	597	(6)	120	(80)	597	0	Not relevant	--
				Maximum acceptable oil product price decrease: -80%		Maximum acceptable increase in oil product consumption: 17%		Implicit growth in consumption that would eliminate excess reserves: 22%	

* Excess reserves available for sale are higher than excess reserves as defined by regulation. Current laws governing CORES' activity only allow computing 90% of physical reserves when assessing compliance with reserve requirements. However, in the event of a sale of excess reserves, this additional 10% of product would be available.

Lastly, in our view CORES could also request an increase in the fees paid by its members 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

Related criteria

- Principles Of Credit Ratings, Feb. 16, 2011
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010

Related research

- CORES, Spanish Strategic Oil Reserves Manager, Ratings Affirmed At 'BBB-/A-3'; Outlook Negative, Oct. 22, 2013
- Corporacion de Reservas Estrategicas de Productos Petroliferos Cut To 'BBB-/A-3' After Action On Spain, Outlook Negative, Oct. 10, 2012
- Government-Related Entities CORES, ICO, And SEPI Downgraded To 'BBB+/A-2' On Spain Downgrade; Outlooks Are Negative, April 30, 2012

Ratings Detail (As Of November 18, 2013)	
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
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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