Analysis

Moody's Global
Corporate Finance

January 2009

Corporación de Reservas Estratégicas de Productos Petrolíferos

Madrid, Spain

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Corporate Profile

CORES' Aaa rating reflects its strategic importance to the Spanish economy and its special legal status as a public entity

Madrid-based Corporación de Reservas Estratégicas de Productos Petrolíferos (CORES) is the organisation responsible for managing the strategic oil reserves and controlling compulsory reserves (petroleum products and natural gas) in Spain. By law, all companies authorised to distribute oil and natural gas products in Spain must be members of CORES, whereby they pay the organisation monthly fees or risk losing their licence.

CORES qualifies as a government-related issuer (GRI) under Moody's methodology. This methodology formally examines four components: (i) the GRI's Baseline Credit Assessment (BCA); (ii) the credit risk of the supporting government; (iii) the default dependence between the GRI and the government; and (iv) the probability of government (systemic) support for the GRI.

In light of CORES' strategic importance to the Kingdom of Spain, its legal status and its specific by-laws, Moody's has assigned the following GRI factors to CORES:

- A BCA of 1 (on a scale of 1 to 21, where 1 represents the lowest credit risk)
- A local currency issuer rating of Aaa to the Spanish government
- High default dependence
- High probability of systemic support

This Credit Analysis provides an in-depth discussion of credit rating(s) for Corporación de Reservas Estratégicas de Productos Petrolíferos and should be read in conjunction with Moody's most recent Credit Opinion and rating information available on Moody's website. Click here to link.

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The BCA of 1 is underpinned by the fact that CORES' business objective is to cover its operating expenses, rather than to maximise its operating cash flow. The operating expenses are guaranteed through the collection of fees from its member companies. (For details of the funding system, see 'Business Risk Factors' below.) Moody's has also taken into account that an adequate liquidity management policy will remain in place to avoid any future liquidity constraints. Not only are all the corporation's operational costs fully matched by fees from members, but the government can order members to make extraordinary contributions to cover operational deficits.

The high default dependence reflects CORES' importance to the national economy, its dependence on the oil sector and its operational and financial proximity to the government. A key factor in Moody's rating assessment is the understanding and assumption that CORES will remain a key component of the Spanish government's strategic oil reserve policy and that it therefore plays an instrumental role for the Ministry of Industry.

The high probability of systemic support reflects CORES' status as a Spanish 'corporation of public law' that cannot be privatised under existing legislation. As such, it is subject to the supervision of the Spanish government through the Ministry of Industry, although it is legally independent from the state and subject to private commercial laws. CORES was created by Royal Decree 2111 in October 1994 with a mandate to constitute, maintain and manage Spain's strategic oil reserves. The Ministry of Industry appoints CORES' chairman for a five-year term. The General Assembly comprises representatives from CORES' member companies. Voting rights are proportional to the annual fee paid by each member. The Ministry of Industry has a right to veto any agreement reached by the General Assembly that could contravene existing laws. Any agreement requires three-quarters of members' votes. So far, the ministry has never exercised its right of veto at the General Assembly. The board of directors is composed of the chairman and 10 members; three are appointed by the Ministry of Industry and seven by the General Assembly. CORES' board of directors approves annual budgets, and the resulting annual fees are then submitted to the ministry and published in the Official State Gazette (Boletín Oficial del Estado), the official newspaper of the government of Spain. Moody's does not expect any changes to the current funding mechanism or the legal status of CORES.

Countries where oil is structurally in high demand as an energy resource but which cannot guarantee supplies due to a lack of domestic production consequently need to hold certain amounts of crude oil and petroleum products in reserve. This is certainly the case for Spain, given that: (i) oil accounts for 51% of total energy resources consumed in the country; and (ii) 99.5% of Spain's oil needs are covered by imports. CORES was created to take responsibility for the strategic oil reserves as well as to control the compulsory reserves to be kept by operators.

Strategic oil reserves are set at half of the minimum security reserves, which are 90 days of sales/consumption of oil products. Thus, CORES is responsible for ensuring that the oil companies operating in Spain maintain 45-day minimum security reserves.

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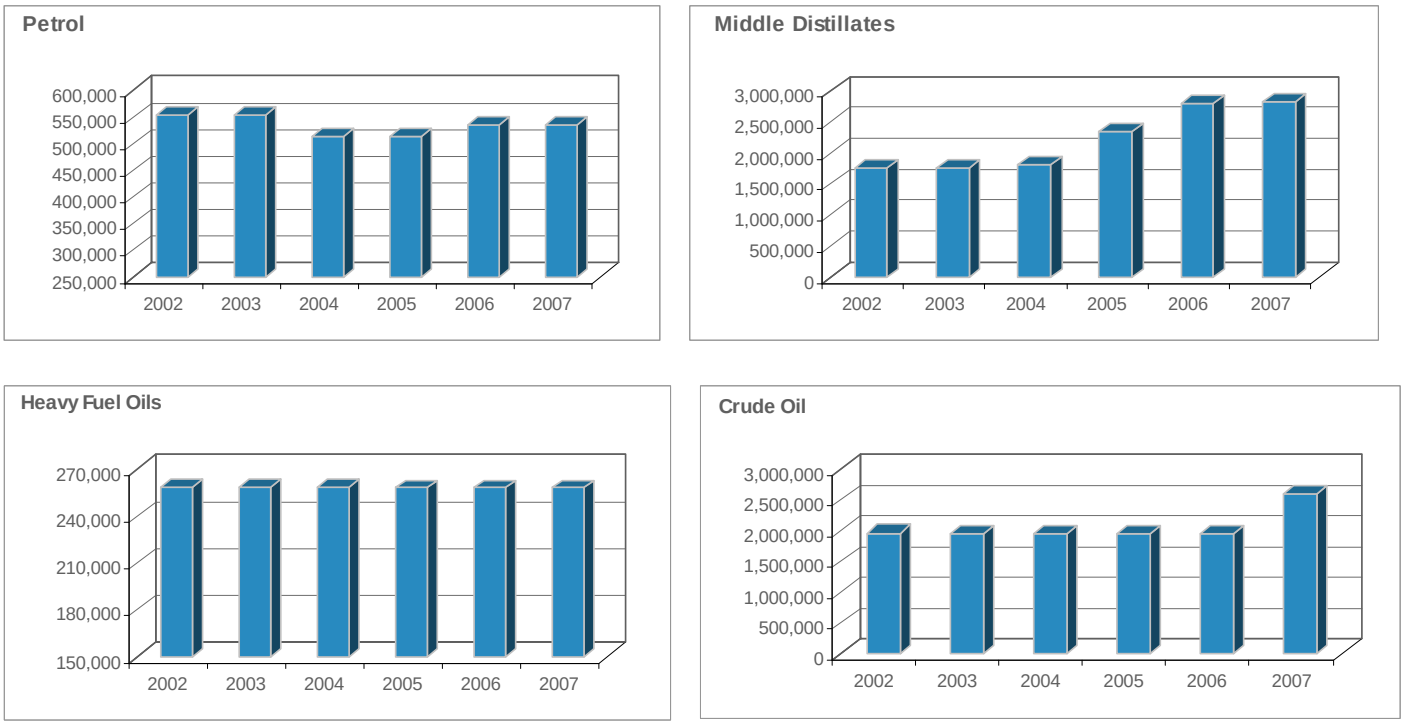
Figure 1 – Strategic Oil Reserves in Spain (Metric Tons)



Source: CORES

CORES holds approximately 6.2 million metric tons of oil products. By product category, 8.6% of CORES' stocks are held in the form of petrol, 4.2% as heavy fuel oils, 45.4% in middle distillates and the remaining 41.8% in crude oil.

CORES is entitled to lease up its oil requirements, although it has not leased any of its strategic reserves to date. The corporation's strategic reserves cannot be pledged or sold except in exceptional circumstances stipulated by law, namely: (i) in the event of a supply shortage; (ii) in the event of an excess of strategic reserves beyond legal requirements; or (iii) in the event of a sale aimed at maintaining the quality of the products. Any decision to sell the strategic reserves has to be made by the government.

Legal Framework

CORES was created in October 1994 by means of Royal Decree 2111, which granted the corporation a mandate to constitute, maintain and manage Spain's strategic oil reserves. CORES is a public-law entity under Royal Decree 1716/2004, which replaced Decree 2111 and Law 34/1998, but has the legal status and capacity to act under private law. Although CORES is subject to private commercial laws, its strategic role means that it is subject to the supervision of the Public Administration, in particular the Ministry of Industry.

CORES has specific characteristics that differentiate it from a private company. Firstly, it has no share capital given that, in accordance with its by-laws, the financial resources that enable it to carry out its activities derived from member fees. Secondly, the corporation cannot be liquidated unless Parliament approves a specific law to that effect. Finally, CORES is partially exempt from corporate taxes given that it does not have to pay corporate income tax on fees received or on any income earned from the disposal of strategic reserves.

Key Rating Considerations

Business Risk Factors

Although CORES has no explicit guarantee from the Kingdom of Spain, its issuer rating relies entirely on its close relationship with and support from the government

As noted above, CORES' Aaa rating reflects its legal status as a public-law entity and Moody's assumption that the corporation will remain a key instrument for the Spanish government's strategic oil reserve policy, as reflected in the legal obligation for oil operators and importers to pay fees to CORES or lose their operating licence. As such, it is highly unlikely that an operator will default on the payment of a fee, even in a distress scenario.

However, the legal nature of CORES is not as strong as that of other Spanish state entities

CORES is a hybrid entity in terms of its legal nature, which is arguably not as strong as that of other rated GRIs in Spain, such as Ente Público Radio Televisión Española (RTVE; rated Aaa) or Sociedad Estatal de Participaciones Industriales (SEPI; rated Aaa). The state does not grant an explicit guarantee on CORES' liabilities, nor does the corporation receive any direct subsidies from the Spanish government (RTVE does) or benefit from a liquidity assurance mechanism in case of financial distress. By law, only CORES' members (which are all oil and gas distributors in Spain) are responsible for the corporation's financial sustainability and the timely repayment of its debts.

Nevertheless, the Aaa rating assigned to CORES is supported by: (i) the importance of the strategic reserves for the Spanish economy; (ii) the clear and specific framework established by law under which CORES operates; and (iii) the close relationship with and support from the government, as evidenced by the Ministry of Industry's role in approving the corporation's member fees and publication of the fees in the Official State Gazette.

The legal mandate that CORES has been granted to ensure compliance with obligations under Spanish law and international regulations with respect to the strategic stockholding of oil products could, in theory, be performed directly by the companies themselves, as is the case in some other countries. However, the operators support the existence of entities such as CORES because it is more efficient, it has greater economies of scale and the financing costs are much lower. In addition, the operators are not burdened by the significant liabilities that would otherwise sit on their balance sheets as a result of financing the acquisition of oil reserves.

CORES' operations and financial activities benefit from a fee-based funding system that provides the corporation with a predictable and flexible financial profile

CORES is funded through the monthly fees that it receives from its members. Moody's derives comfort from the fact that all oil operators and importers in Spain are required by law to pay these fees and that failure to do so can ultimately result in termination of the operator's activities. In the event of any delay in payments from any of its members, CORES charges a penalty of 300 basis points over the official Spanish interest rate for the duration of the delay. By law, failure to settle the fee is considered a serious infraction and could result in termination of the operator's licence.

Such a threat makes it highly unlikely that an operator would not pay the fee. In fact, members regularly comply with payment obligations and, since CORES' creation, defaulted payments have been negligible. At year-end 2008, no overdue fees have been recorded.

By law, the fees paid to CORES – which constitute its main cash inflow – must be calculated to ensure that they cover the following: (i) financial costs, which are mainly debt interest payments; (ii) all operational costs derived from the constitution, storage and maintenance of the strategic reserves; (iii) administrative costs; and (iv) the allocation of the Statutory Financial Reserve up to a limit of 25% of ordinary annual expenses.

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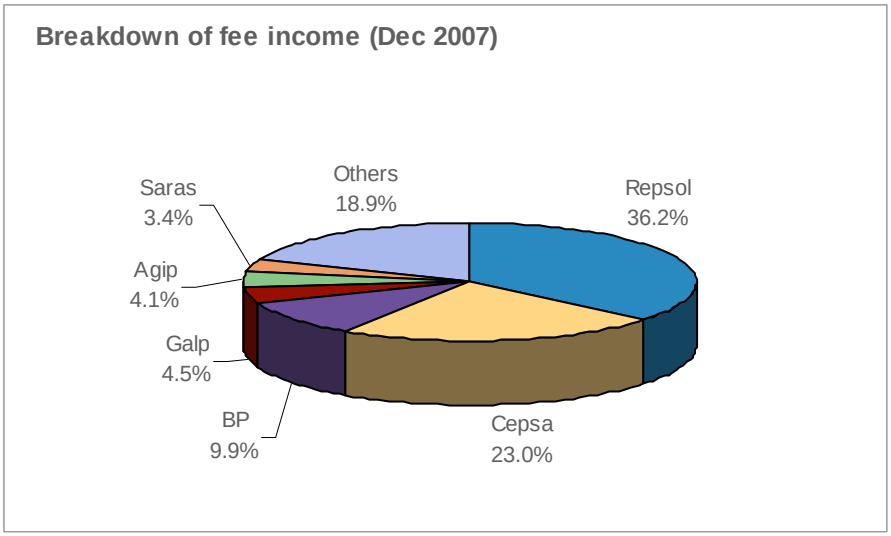
CORES' board of directors decides whether any excess fees left after these costs have been covered are to be paid back to CORES members, and it allocates the remaining surplus to the Statutory Financial Reserve.

In the event of unforeseen circumstances that could put CORES' liquidity and/or solvency at risk, the government is entitled by law to oblige CORES' members to pay an extraordinary fee. To date, a conservative budgetary policy has resulted in fee surpluses arising in every year of CORES' operation.

Some concentration risk from reliance on the two largest oil companies in Spain

We note a certain concentration risk given that CORES' two largest contributors together pay 59.2% of its fees – Repsol YPF S.A. (Repsol; rated Baa1) accounts for 36.2% and Compañía Española de Petróleos S.A. (Cepsa; not rated) for 23.0%. However, these fees represent only a minimal proportion of these companies' total annual expenses. In addition, as the Spanish oil market becomes more competitive, these two operators' share in CORES' fee income should decline gradually.

Figure 2 – Fee Income by Operator

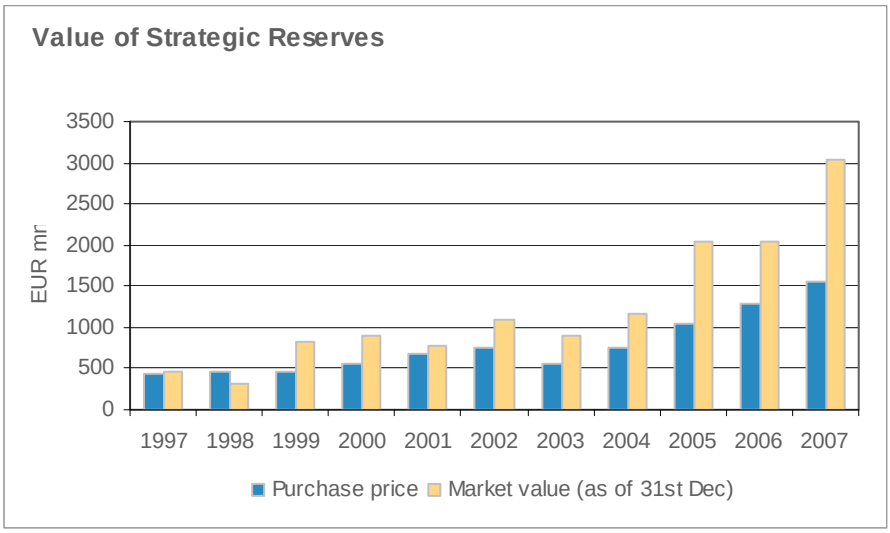


Source: CORES

A highly marketable asset base

One of CORES' specific characteristics is the marketability of its asset base, given that oil reserves represent 97.16% of its total assets. The corporation's oil stock was purchased at significantly lower prices than current market prices and CORES therefore has a 'cushion' in terms of valuation of its stock of around €1.7 billion. Furthermore, in the event of a supply crisis – in which case CORES would have to sell its reserves if instructed to do so by the Spanish government – the market price would be considerably higher than the acquisition cost of strategic reserves.

Figure 3 – Acquisition Cost vs. Market Price of Strategic Reserves



Source: CORES

By law, in event of a sale of stock, cash proceeds will be used to reduce debt

On the operational side, CORES requires the government's authorisation to release strategic oil reserves if the sale price is below the average acquisition cost and/or if there is an imminent or existing disruption in the supply of oil products. In such a crisis scenario, the government would decide by legal decree how to use and release both CORES' strategic stocks and the operators' security reserves. The proceeds from the disposal of reserves would be applied first to the redemption of debts contracted by the corporation.

CORES does not own all its storage capacity, but there is a plan to build more

To date, CORES has rented facilities from third parties to store its crude oil and petroleum products, thereby providing the corporation with operational flexibility. However, the need to build up increasing stores of strategic reserves in light of the persistent growth in consumption and market pressure in terms of the availability of rented storage have prompted CORES to explore the possibility of using its own facilities in recent years. Own-storage facilities would either be built directly by CORES or by means of any other option allowing their long-term use.

Currently, CORES has 7,646,478 cubic metres stored (including both crude oil and finished product). Of this capacity, 400,000,000 cubic metres are stored in its own facilities, whilst the rest is stored in facilities rented from third parties – e.g. Compañía Logística de Hidrocarburos CLH S.A. (not rated), Repsol, Cepsa, BP plc (rated Aa1), Meroil (not rated) and Decal (not rated). In January 2009, some facilities built in Cartagena began operations, with a capacity of 200,000 cubic metres.

Financial Risk Factors

Revenues and margins are predictable due to fee-based funding system

As noted above, by law the fees paid to the corporation are calculated so as to cover all of its operational, financial and administrative costs, and the government can order members to make an extraordinary contribution in the event of an operational deficit. As a result, CORES enjoys highly predictable revenues and margins.

The largest items within CORES' cost base are rental expenses and financing costs (62% and 36%, respectively), while administrative costs are marginal (only 2% of the total) given the lean structure of the corporation.

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Figure 4

Operating Budget

(€m)	2009E	%
Rental expenses	141.4	61.5%
Financing costs	83.8	36.4%
Administrative costs and others	4.8	2.1%
Total operating expenses	230.1	100.0%
Companies' fees	230.1	100.0%
Other income (interests, others...)	0.0	0.0%
Total operating income	230.1	100.0%

Source: CORES

Leverage is high and expected to increase over the medium term

CORES' high debt leverage reflects the acquisition cost of the oil reserves, which has been financed with external debt. In addition, it rents storage from third parties as it does not own enough storage capacity. Adjusting debt for operating leases results in an even higher financial leverage position.

Furthermore, CORES still needs to issue additional debt to increase its reserves to meet the minimum requirement of 45 days of sales/consumption of oil products (CORES currently holds 40.5 days).

Figure 5

Leverage

(€m)	2006	2007	2008E	2009E
Debt due < 1year	668.7	556.4	76.7	130.7
Debt due > 1year	572.3	960.3	1,680.3	1,917.9
TOTAL DEBT	1,241.0	1,516.7	1,757.0	2,048.6
Operating lease * 5	471.5	513.8	598.8	663.7
TOTAL ADJSUTED DEBT	1,712.5	2,030.4	2,355.8	2,712.3
Cash & Short Term Investments	0.0	0.0	0.0	0.0

CORES is developing its plan for the next 12 months, which consists of bilateral facilities of €300 million, which entails the purchase of additional oil stock (to have 44.7 days of sales/consumption of oil products by year-end 2009) and some bond issuance.

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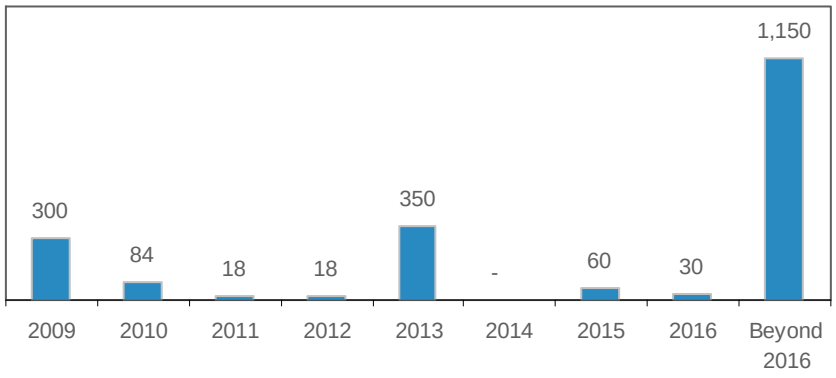
Figure 6

CORES - Debt maturity profile (December 2008)



Source: CORES

The corporation executes all of its transactions in euros to avoid any exchange-rate risk. However, it is exposed to the fluctuation in oil prices given that these are denominated in US dollars and that the corporation does not trade in the commodities futures market.

Moody's has taken into account that CORES will retain an adequate liquidity management policy to avoid any future liquidity constraints.

Moody's Related Research

Analysis:

- Government of Spain, September 2008 (111250)

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

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Report Number: 114183

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