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Corporación de Reservas Estratégicas de Productos Petrolíferos (CORES)

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 products in Spain - both operators and importers - must be members of CORES and pay its monthly fees or risk losing their licence.

CORES qualifies as a Government-Related Issuer (GRI) under Moody's methodology. This methodology formally disaggregates the ratings of GRIs into four components: (i) the GRI's baseline credit risk, (ii) the credit risk of the supporting government, (iii) the default dependence between the GRI and the government, and (iv) the likelihood of government 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:

- A baseline credit assessment of 1 (on a scale of 1 to 21, where 1 represents the lowest credit risk)
- Aaa local currency rating of the Spanish Government
- High dependence
- High support

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

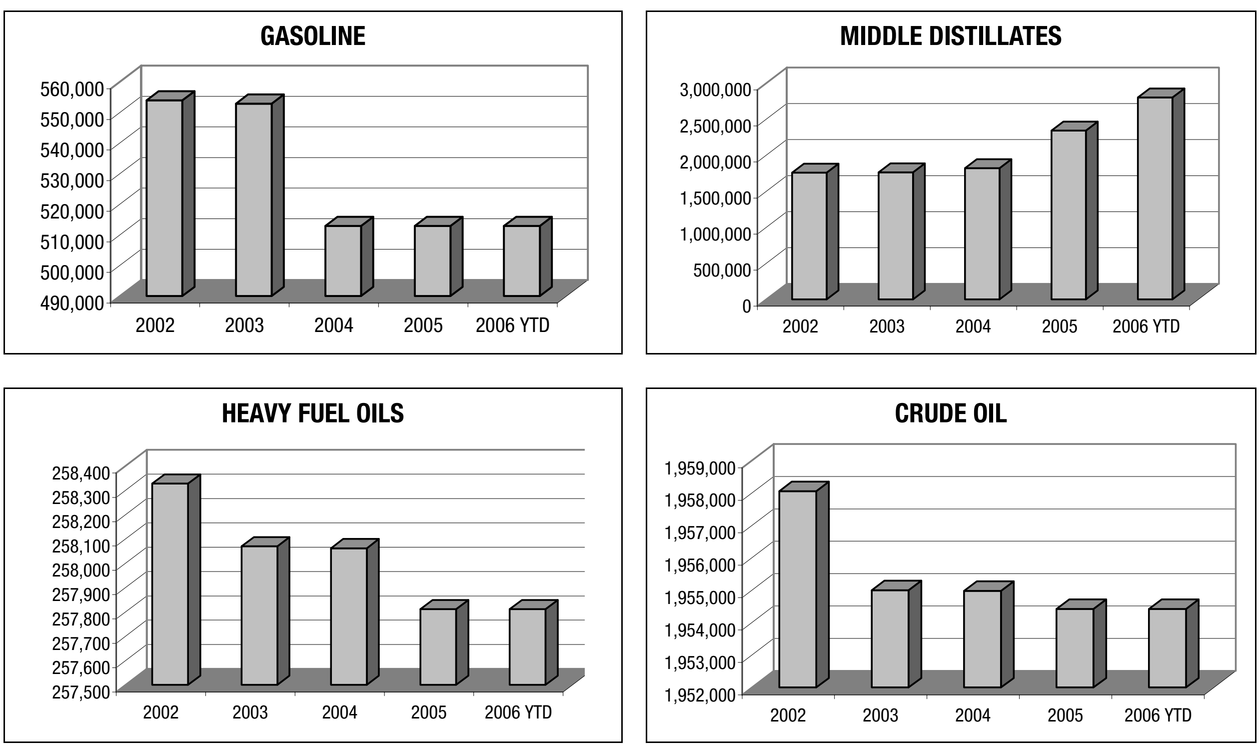
The **high dependence** reflects CORES' importance to the national economy, its dependence on the oil sector and its operational and financial proximity to the government. A key factor in Moody's rating assessment is the understanding and assumption that CORES will remain a key component of the Spanish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

The **high 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 stocks. 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 of veto on any agreement reached by the General Assembly that could contradict 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 11 members: three are appointed by the Ministry of Industry and eight by the General Assembly. CORES' Board of Directors approves annual budgets, which are then submitted to the Ministry and based on which the fees are approved in the Official Spanish Gazette. Moody's does not expect any changes to the current funding mechanism or the legal status of the entity.

Countries in which 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 (1) oil accounts for 51% of total energy resources consumed in the country and (2) 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 for controlling the compulsory reserves to be kept by operators.

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

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



Source: CORES (as of September 2006)

CORES holds approximately 5.5 million metric tons of oil products. By product category, 9.9% of CORES' stocks are held in the form of gasoline, 4.7% as heavy fuel oils, 50.7% in middle distillates and the remaining 35.4% in crude oil. CORES endeavours to keep its reserves in crude oil as high as possible, given its preference for greater flexibility and lower maintenance costs for crude oil.

CORES is entitled to lease up to 50% of its oil requirements, although it has not so far leased any of its reserves designed for covering strategic reserves. The corporation's 45-day minimum reserves cannot be pledged or sold except for exceptional circumstances stipulated by law, namely: (1) in the event of a supply shortage, (2) in the event of an excess of strategic reserves beyond legal requirements, or (3) by means 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 stocks. Under Royal Decree 1716/2004, which replaced Decree 2111, and Law 34/1998, CORES is considered as a corporation governed by public law, but with a legal personality 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 derive from member fees. Secondly, the corporation cannot be liquidated unless a specific law to that effect is approved by Parliament. 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 (Aaa), 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 public law entity and Moody's assumption that the company will remain a key instrument for the Spanish government's strategic oil reserve policy, as reflected in the legal obligation on 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 in the payment of the fee, even in a distressed 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 RTVE (Aaa) or SEPI (Aaa). The State does not grant an explicit guarantee on CORES' liabilities, nor does the company receive any direct subsidies from the Spanish government (whereas RTVE does) or benefit from a liquidity assurance mechanism in case of financial stress. By law, only CORES' members (which are all oil distributors in Spain) are responsible for the entity's financial sustainability and the timely repayment of its debts.

Nevertheless, the Aaa rating assigned to CORES is supported by (1) the importance of the strategic reserves for the Spanish economy, (2) the clear and specific framework established by law under which CORES operates, and (3) the close relationship with and support from the government, evidenced by the Ministry of Industry's role in approving the corporation's member fees and the publication of the fees in the Official State Gazette (Boletín Oficial del Estado).

The legal mandate which 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, there are 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 entity 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 within a period of 45 days is considered a serious infraction and could result in a termination of the operator's licence.

Such a threat makes it highly unlikely that an operator will not pay the fee. In fact, members regularly comply with payment obligations and, since CORES' creation, defaulted payments have been negligible. To date in 2006, no overdue fees have been recorded.

By law, the fees paid to CORES - which constitute its main cash inflow - must be calculated so as to ensure that they cover the following: (1) financial costs, which are mainly debt interest payments; (2) all operational costs derived from the constitution, storage and maintenance of the strategic reserves; (3) administrative costs; and (4) the allocation of the Statutory Financial Reserve.

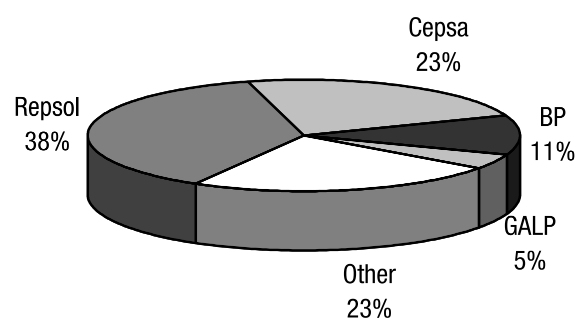
CORES' Board of Directors decides whether any excess fees that are left over after these costs have been covered are to be paid back to CORES members, and it allocates the remaining surplus to the Statutory Financial Reserve.

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 budgeting policy has resulted in fee surpluses arising in every year since CORES started to operate.

There is some concentration risk, as CORES relies significantly on Repsol and Cepsa, the two largest oil companies in Spain

We note a certain concentration risk given that CORES' two largest contributors together pay 60% of its fees - Repsol-YPF S.A. (Repsol; Baa1) accounts for 37.40% and Compañía Española de Petróleos S.A. (Cepsa, not rated) for 23.33%. 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 (as of September 2006)

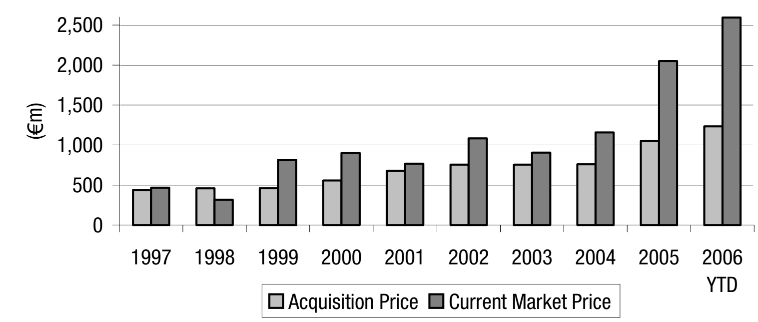


Source: CORES

CORES' asset base is highly marketable

One of CORES' specific characteristics is the marketability of its asset base, given that oil stocks represent 97.53% of its total assets. The company'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 €1.36 billion. It is also worth noting that, in the event of a supply crisis (in which case CORES would have to sell its reserves if the Spanish government were to so decide), the market price would be considerably higher than the acquisition cost of strategic reserves.

Figure 3 - Purchase price 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 storage capacity, although there is a plan to build some

To date the storage of the crude oil and petroleum products owned by CORES has taken place in facilities rented from third parties. On the one hand, renting storage capacity provides the corporation with operational flexibility. However, the increasing need to build up strategic reserves in light of the persistent growth in consumption - combined with the existence of market pressure in terms of the availability of rented storage - prompted CORES to decide, at the end of 2002, to explore the possibility of using its own facilities, either by building them directly or by means of any other option allowing their long-term use.

Currently, CORES has 6,431,165.091 cubic metres stored (including both crude oil and finished product). Of this capacity, 200,000 cubic metres is stored in its own facilities, whilst the rest is stored in facilities rented from third parties (e.g. CLH, Repsol, Cepsa, Bp, Meroil, Decal). Another 200,000 cubic metres is under construction and will be delivered at the beginning of 2007. In addition, a third party is currently building facilities in Gijón for a further 240,000 cubic metres; CORES will initially rent these facilities but will take ownership of them after a number of years.

Financial Risk Factors

Predictable revenues and margins 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 (74% and 23%, respectively), while central costs are marginal (only 3% of the total) given the lean structure of the corporation.

Revenues and Profitability

	2004		2005		1H 2006
(€m)	As Reported	Adjusted	As Reported	Adjusted	As Reported
Revenues	98.9	98.9	110.5	110.5	84.1
Revenues Growth (%)	-	-	11.7%	11.7%	N.M.
EBITDA	20.4	45.7	73.1	107.2	29.6
EBITDA Margin (%)	20.6%	46.2%	66.2%	97.0%	35.2%
EBIT	20.4	45.7	22.5	50.7	29.3
EBIT Margin (%)	20.6%	46.2%	20.4%	45.9%	34.8%
Net Interest	(15.9)	(19.0)	(41.2)	(47.2)	(15.8)
Net Income	4.3	4.3	3.5	3.5	13.1
Net Income Growth (%)	-	-	(18.9)%	(18.9)%	N.M.

Source: CORES' Annual and Interim Reports / Moody's

Leverage is high and is expected to increase over the medium term

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

In addition, the government has, through Royal Decree 1716/2004, recently increased the number of days of sales/consumption of oil products for which CORES is responsible from 30 to 45. CORES needs to raise additional debt in order to increase its reserves to meet the new requirements.

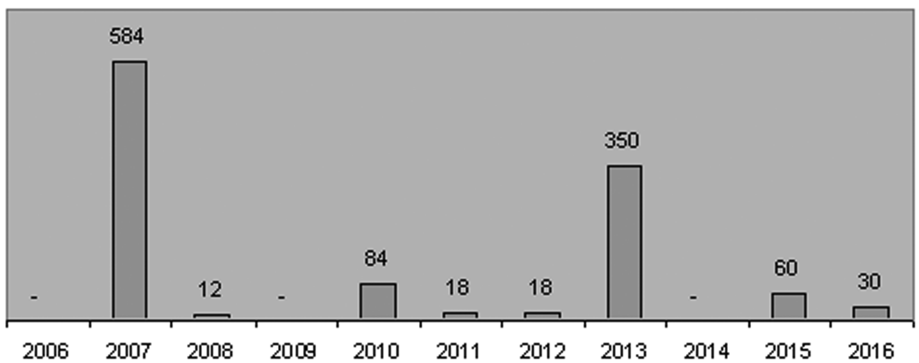
Liquidity

(€m)	2004	2005
Debt due < 1year	1.0	299.0
Debt due > 1year	671.0	671.0
TOTAL DEBT	672.0	970.0
Operating lease * 8	379.5	423.5
TOTAL ADJSUTED DEBT	1,051.5	1,393.5
Cash & Short Term Investments	0	0

Source: CORES' Annual Reports / Moody's

Figure 6 - Liquidity

CORES - Debt maturity profile as of Sep 2006 (€m)



Source: CORES

Management is currently working on improving the corporation's liquidity profile: debt maturities in excess of €1 billion in 2007 are substantial. CORES is also working on its refinancing plan for the next 12 months, which consist of approximately €550 million in bilateral bank facilities and some €1 billion in bond issuance.

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

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

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