STANDARD & POOR'S

COMPANY CREDIT REPORT

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AAA/Stable/A-1+

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Corporación de Reservas Estratégicas de Productos Petrolíferos

Major Rating Factors

Strengths:

- Increasing strategic importance for the state and Spanish economy;
- Very strong implicit legal status; and
- Solid and predictable funding profile.

Weaknesses:

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

Rationale

The ratings on Corporación de Reservas Estratégicas de Productos Petrolíferos (CORES) are based on expected and continued support from the Kingdom of Spain (AAA/Stable/A-1+). This expectation is justified by CORES' strategic importance for the national economy and its legal status as a public entity, which implies tight supervision by the Spanish state and the latter's ultimate responsibility for all of the entity's obligations. CORES benefits from a favorable regulatory environment, characterized by a full-cost, fee-based funding system that provides it with a predictable and flexible financial profile.

CORES' legal mandate is to ensure compliance with obligations under Spanish law and international regulations regarding the strategic stockholding of oil and gas products. CORES was established in 1994 as a public entity and its legal status can only be changed by law.

CORES does not receive any funds from the government, nor has the state granted an explicit guarantee of CORES' liabilities. The law does not, however, preclude the granting of state financial support to CORES in a potential stress scenario.

CORES is funded exclusively through the monthly quotas it receives from its members. All oil and gas operators and importers in Spain are required by law to pay fees to CORES; failure to do so can eventually result in the termination of an operator's activities. By law, fees are set to cover all operating, financial, and administrative costs. In the event of unforeseen circumstances that could put CORES' liquidity and/or solvency at risk, the government is entitled by law to charge an extraordinary fee to CORES' members at any time.

Default and arrears on fee payments have, to date, been of minimal importance. Fee income surpluses and the selling of stocks at a profit have enabled CORES to gradually build up its financial reserves, which are expected to have totaled €66.5 million at year-end 2005. CORES borrows funds in the financial markets to finance the purchase of oil stocks. It has easy access to the international financial markets, which reflects the state support ensured by its legal framework. CORES' outstanding long-term debt was an estimated €671.5 million at year-end 2005, bearing no currency risk.

Outlook

The stable outlook reflects the likelihood that CORES, based on its strategic role for the Spanish economy, will keep receiving strong implicit government support given that Spain's oil imports account for nearly 100% of the country's consumption needs. Standard & Poor's Ratings Services does not expect any changes to CORES' legal or regulatory status that would undermine its creditworthiness in the foreseeable future, given the continued strategic importance of the entity for the Spanish government. Total debt is expected to increase to €2 billion by year-end 2007, owing to the requirement to increase reserves gradually to 45 days of supply. This growth is unlikely to erode CORES' financial solvency or liquidity, however, given that the financial cost increase associated with the debt rise will be offset by fee hikes, which are expected to be absorbed easily by members.

Background And Business Description

Spain imports almost 100% of its oil consumption needs, resulting in a high dependence on foreign supplies and risk associated with a potential disruption of international oil supply links. The Spanish government addressed this need as early as 1927, by maintaining minimum-security oil reserves, which, at the time, were equivalent to four months of oil product consumption. This strategic policy has essentially been maintained to date.

As a member of the International Energy Agency and the EU, Spain must maintain minimum stocks for three groups of oil products, equivalent to 90 days of supply and consumption (for the list, please see the "Operations" section below), calculated based on the average consumption levels in the previous year.

The Spanish government shares the holding of such minimum-security reserves equally with the sector operators. This differs from the position in other EU countries like Germany, where all minimum-security reserves are held by solely by the state either directly or indirectly through state-owned entities, such as the German state-owned Erdoelbevorratungsverband (AAA/Stable/A-1+).

Government mandate to CORES

The Spanish government created CORES in 1994 by royal decree, granting it the mandate to constitute, maintain, and manage the minimum-security oil stocks held by the Spanish government. At that time, the strategic reserve requirement was 33% of the 90-day required minimum-security reserves of national oil product consumption. The remaining two-thirds had to 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. Since 2004, CORES' strategic oil reserves requirements have been increased to 50% of the minimum-security reserves, i.e., 45 days of sales and consumption of oil products.

CORES is also obliged to: insure its strategic oil reserves fully; maintain the stocks' quality and adequacy for consumption at all times; store the stocks evenly throughout 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 scenario, it is the government's responsibility to establish by decree the use and release procedures of the minimum-security reserves, including CORES' strategic oil reserves.

Since 2004, CORES' mandate has also included 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 35 and 20 days, respectively), and that no more than 60% of gas resources are provided by any one country. Reflecting the new mandate, CORES' board of directors has increased its number to incorporate new representatives from the gas sector and the Comisión Nacional de Energía. Apart from this change, CORES' supervision of gas reserves, which started in 2004, has not had, and is not expected to have, any significant impact on the corporation's structure, financials, or the way it carries out its operations.

Legal Status

CORES' legal status is 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 and the increased requirement in strategic oil reserves held by CORES, the risks of change in legal status and privatization are negligible.

CORES is subject to the supervision of the Spanish government under the tutelage of the Ministry of Industry. Due to its strategic importance, CORES' governing laws restrict its activities to those of a special-purpose entity with a clearly defined strategic role. For efficiency reasons, CORES is subject to private commercial laws and enjoys a large degree of operational independence, however.

CORES does not receive any public funds, and the state does not grant any explicit guarantee for the company's liabilities, even though it could do so according to the current laws. Although the state is ultimately liable for CORES' obligations, only CORES' members financially support the entity's operations and debt repayment.

Government Role, Organization, And Management

The Ministry of Industry nominates CORES' president for a five-year term and has to approve the entity's annual accounts and set the unit quotas that will determine the fees paid by CORES' members and nonmembers. By law, the unit quotas must cover all CORES' operational, financial, and administrative expenses. The Ministry of Industry is also entitled to impose an extraordinary quota on CORES members at any time and for any period if CORES' financial position and solvency are at risk for any reason. No extraordinary quotas have been imposed to date because the budget is drafted so that ordinary quotas include a reasonable cushion for cost increases.

Operationally, CORES requires the government's authorization to release any strategic oil reserves (see "Stock-release procedures" within the "Operations" section below).

The General Assembly comprises CORES members. Voting rights are proportional to the annual quota paid by each member. The Ministry of Industry has a right of veto. 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 president and 11 members: three are nominated by the Ministry of Industry, and eight by the General Assembly (of whom five represent operators in the oil sector, two the gas sector, and one the LPG sector). Decisions require the presence of seven board members, and a simple majority applies. The president has a right of veto over any agreement reached by the board that is contrary to existing laws.

Operations

Stockholding and storage operations

Minimum-security reserves can be held in three different types of oil products: gasoline; middle distillates (diesel, kerosene, and jet fuel); and heavy fuel oils. Reserve requirements for each product category are recalculated every month and correspond to the 90-day average of sales and consumption in the preceding calendar year (with data allowing for a lag of three months).

CORES' recent obligation to increase stocks to create the 45-day reserves can be fulfilled through acquisitions in the open market and, up to a maximum of 50% of total strategic reserves, through leasing contracts with oil operators. At present, CORES does not have its own storage facilities, but rents capacity from third parties. It is building three storage facilities, which will become operational in 2006, with capacity for 10%-20% of its storage needs. This will allow CORES to make savings in storage costs, while increasing the limited availability of storage capacity in Spain's oil market.

The leasing of stocks and renting of storage capacity must be carried out so as not to alter prices or market conditions. In addition, CORES' members are obliged to sell and lease stocks and rent storage capacities as required by CORES. To date, no member has refused to cooperate with CORES.

The previous obligation to maintain the 30-day reserves obligation was fulfilled in 2001, six years after CORES started operations, reflecting the difficulties associated with building up such a large stock of oil products, despite more favorable oil prices than at present. CORES' stocks at year-end 2005 accounted for 31.6 days of supply. The corporation plans to increase reserves gradually so as to have 36.4 days of supply at year-end 2006, and reach 45 days by the end of 2007, as required by law. The strategy of building up the stocks, however, may vary according to oil price developments, and will ultimately be dictated by the Ministry of Industry.

Small surpluses and deficits in relation to the required stock are normal, due to stock rotation to maintain quality and the impact of market prices on CORES' trading strategy.

Stock-release procedures

CORES can release strategic oil stocks in two ways:

- When reserves are in excess of the legally required 45-day quota, in order to maintain the quality of the oil stocks, or if the market price exceeds the acquisition cost, CORES' board of directors may decide to sell stocks at its discretion.
- If the sale price is less than the acquisition cost and/or in the event of an imminent or existing disruption to oil supplies, CORES may only release strategic stocks on the terms decided by, and upon authorization of, the Ministry of Industry.

Any profits derived from the sale of oil products must be allocated to a special reserve. By end-December 2005, the special reserve amounted to €36.8 million. Since the creation of CORES, stocks have never been sold at a price below their average cost, nor have they been released due to disruption or a crisis affecting the supply of oil.

CORES finances its purchases of oil products largely through borrowed funds.

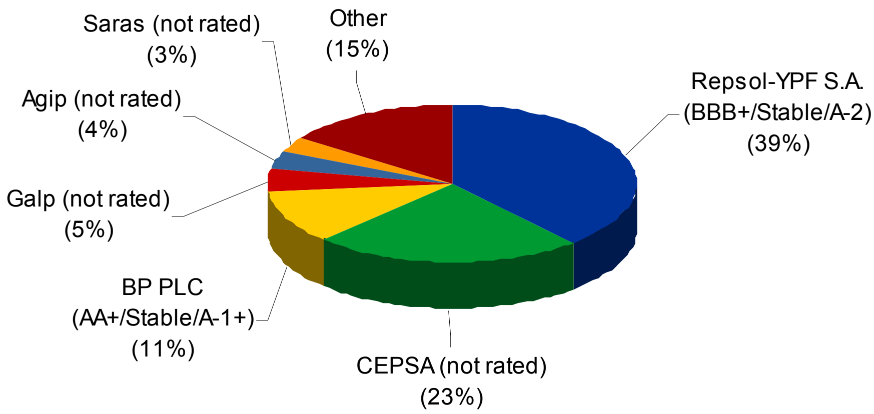
Membership And Fee System

Membership

All oil operators authorized to distribute oil products and LPGs and, since 2004, carriers of natural gas in Spain are legally obliged to be members of CORES. Retail distributors and consumers of imported oil and gas products are obliged to pay monthly fees to CORES but do not have member status. The number of CORES members has increased to 130 from 41 at year-end 2003, largely due to the incorporation of members from the LPG and natural gas sectors. Members from the oil sector, however, continue to contribute almost 99% of the company's total fee income.

Chart 1

CORES Members' Contribution To 2005 Total Fee Income



Fee system

The law establishes that fees must be calculated so as to cover all the corporation's costs: financial, operational, administrative, and the allocation to the statutory reserve. This full-cost pricing ensures CORES' financial viability despite sharp increases in costs, because the quota does not represent a material burden within the cost structure of any of the members.

Members and nonmembers' fees are payable monthly without notice by applying the unit quotas to the volume of metric tons of products sold or consumed in the preceding month by each member and nonmember. In the event of delayed payments, CORES charges a penalty of 300 basis points over the legal Spanish interest rate (4% in 2005) for the duration of the payment moratorium. By law, failure to settle the fee within 45 days is considered a grave infraction. The Ministry of Industry will take action against the operator, which could eventually result in the termination of its license. Given this incentive, the rate of nonpayment is expected to remain nil or negligible.

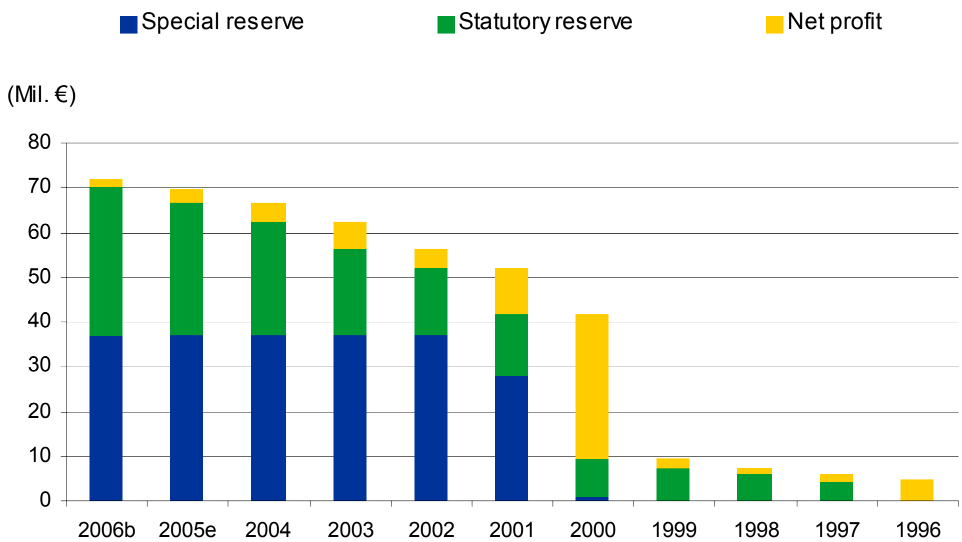
CORES' board of directors must elaborate a nonbinding balanced annual budget, with the sole purpose of proposing unit quotas. The budget must include projections of all costs. These costs must be allocated to the oil product categories in proportion to the projected strategic reserve requirements for each category. In turn, fees receivable from sales and consumption of each type of product must cover projected expenditures per product category. Unit quotas per metric ton of product sold and consumed are then calculated, dividing the projected total fee income per product category by the projected volume of oil sales for the budgeted year.

The quotas are made official and legally binding by ministerial order early in January in 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 is entitled to impose an extraordinary quota on CORES' members and nonmembers. To date, no extraordinary quota has been approved given the conservative policy in setting unit quotas, which has resulted in fee surpluses every year since CORES started to operate.

CORES' board of directors decides whether any of the excess fee is to be paid back to the members, and it allocates the remaining surplus to the statutory reserve. Although members have never demanded that CORES should return excess quotas, the board of directors usually decides to do so as a signal of its willingness to contain fee levels. There are no specific limits on the amount allocated to the statutory reserve, although CORES' management has aimed to build up a reserve covering three months of total fee income. At year-end 2005, the statutory reserve is expected to have amounted to €29.7 million, equivalent to 3.3 months of fee income, up from 2.3 months in 2003. Total equity is expected to have been €71.8 million in 2005, almost 10 months of fee income.

Chart 2

Evolution of CORES' Financial Reserves



e--estimated b--budgetted

Since CORES' creation, defaulted payments have been immaterial, and members have routinely complied with payment obligations. At year-end 2005, overdue fees are expected to have been nil. Penalty charges for delayed payments are usually negligible, and mostly due to administrative errors of minor importance. CORES relies on Repsol-YPF, S.A. (BBB+/Stable/A-2) and Cepsa, the two largest oil operators in Spain, for more than 60% of its annual fee income, although quotas paid to CORES by the operators represent a minimal amount of their annual total expenses. The share of these two operators in CORES' total fee income should gradually decline—as has happened in recent years—as the Spanish oil market becomes more competitive. The concentration of CORES' fee income among a small number of operators does not pose a significant risk to its financial and funding profile, due to the special features of the entity's funding system.

Provisions against member bankruptcies

If an oil operator goes bankrupt, it ceases to operate in the market and competitors take over the failed operator's market share. The quotas due each month by members are calculated by applying the unit quotas to volumes of oil products sold in the previous calendar month by each operator, and so each member's monthly quota is automatically adjusted to reflect any changes in the market structure. Any disruptions to CORES' revenue stream should be of short duration and would be unlikely seriously to affect the company's ability to carry out its operations. In any case, the Ministry of Industry can set an extraordinary quota on members and nonmembers of CORES if circumstances require.

Finances

Table 1.

Corporación de Reservas Estratégicas de Productos Petrolíferos Financial Ratios					
	—Year ended Dec. 31—				
(%)	**2005e**	**2004**	**2003**	**2002**	**2001**
Balance sheet					
Growth of assets	39.4	(0.3)	0.0	9.8	24.2
Growth of financial liabilities to banks and other creditors	39.5	(0.3)	0.0	10.1	24.0
Liquidity and reserves					
Reserves and retained earnings/liabilities	7.0	9.5	8.8	7.9	8.1
Reserves from stock sales/value of compulsory stocks	3.5	4.9	4.9	4.9	4.1
Cash plus short-term assets/interest payments	0.0	0.0	62.6	48.4	46.2
Cash plus short-term assets/total operating expenditures	0.0	0.0	12.7	12.3	13.6
Statutory reserve (in months of membership fees)	3.3	3.1	2.4	1.8	1.8
Profitability					
ROA (surplus/assets)	0.3	0.6	0.8	0.6	1.5
Surplus/revenues	2.8	4.3	5.9	4.3	10.4
Growth in earnings (surplus)	(29.0)	(27.4)	37.5	(58.4)	(67.8)
Structure of revenues and expenditures					
Administrative costs/total expenditures	2.9	4.2	2.8	2.7	4.0
Interest payments/total expenditures	18.0	16.6	20.3	25.4	29.4
Storage costs/total expenditures	79.1	79.2	76.8	71.9	66.7
Membership fees/total revenues	100.0	98.5	99.2	100.8	91.8
Surplus brought forward/total revenues	2.9	4.3	5.9	4.3	10.4
Average cost of financial liabilities					
Interest payments/long-term liabilities	2.9	2.4	2.9	3.7	4.2

e—Estimated.

Profit and loss account

CORES' largest operational expenditures are the maintenance and storage of the strategic stocks, which, at €84.4 million estimated for 2005, accounted for 79% of total operational costs (see table 1 above). Interest expenditures have increased gradually since CORES' creation, reflecting the buildup of oil reserves through debt financing. The low interest-rate environment has contained the growth of financial costs, however, which has been lower than debt growth. Interest rates are expected to keep growing until 2007, following debt increases derived from the requirement to increase strategic reserves up to 45 days of supply. Personnel costs, at an estimated €3.1 million at end-December 2005 (see table 2), represented just 3% of total operational costs.

Fee income, at €109.8 million in 2005, accounted for almost 100% of total operating income. CORES has made a profit every year since it started operations. In 2005, net profits are expected to have totaled €3.1 million, slightly lower than the last two years. Although CORES' budget has to balance operational costs and revenues, it is nonbinding, and the actual outcome since CORES' creation has always been a fee surplus, part of which is usually paid back to CORES members, with the remainder allocated to the statutory reserve. Profits from the sale of stocks are allocated to the special reserve and cannot be distributed to the members.

Table 2.

Corporación de Reservas Estratégicas de Productos Petrolíferos Profit And Loss Account

	—Year ended Dec. 31—				
(Mil. €)	**2005e**	**2004**	**2003**	**2002**	**2001**
Income	109.8	100.4	100.2	101.0	99.3
Membership fees	109.8	98.9	99.4	101.8	91.1
Change in stocks	0.0	1.4	0.0	(1.0)	8.0
Financial income and other	0.0	0.1	0.8	0.2	0.2
Expenditures	106.6	95.8	94.2	97.7	89.0
Maintenance of stocks	84.4	75.9	72.3	70.2	59.3
Financial expenditures	19.2	15.9	19.2	24.8	26.1
Administrative expenditures	3.1	4.1	2.7	2.6	3.5
Net profit	3.1	4.3	5.9	4.3	10.3
Sales of stocks	N.A.	0.0	0.0	0.0	8.8
Excess fees	N.A.	4.2	5.1	4.1	1.6
Financial operations and others	N.A.	0.1	0.8	0.2	0.0

e—Estimated. N.A.—Not available.

Balance sheet

In 2005, CORES' strategic oil reserves, estimated at €1,410 million, represented 97% of total assets. Oil stocks are valued at the average acquisition cost. At year-end 2004, the market value of CORES' stocks was €1,157 million, compared with €757 million of average acquisition cost.

CORES' long-term debt remained stable during 2005, at €671.5 million (see table 3). By contrast, short-term debt increased by €299 million as the corporation had recourse to its €800 million short-term facilities in order to finance its reserve increase needs during 2005. CORES expects to refinance the bulk of its short-term debt with long-term debt in 2006. Loans account for 48% of CORES' total long-term debt. This level was largely unchanged compared with 2003, but is almost 50% lower than in 2002. The significant decline in loans reflected CORES' €350 million bond, issued in July 2003 to prepay part of CORES' most onerous loans outstanding, thereby smoothing the company's debt maturity profile (see chart 3). CORES is expected to return to the bond markets when conditions are suitable, to meet part of its increasing financing needs. Overall, debt costs associated with the need to build up an additional 15 days of strategic oil reserves, debt repayments, and financing the construction of storage facilities are likely to increase debt to €2 billion by year-end 2007.

All CORES' borrowings are denominated in euros. Reflecting the state support provided by its legal framework, CORES has access to the Spanish financial markets on very favorable terms. In addition, it has two credit lines of €80.1 million each, with only €700,000 outstanding at year-end 2004. CORES' special legal status implies that the entity does not have capital, but the law obliges it to build up a financial reserve, which, by year-end 2005, amounted to €66.5 million (including the special and statutory reserves).

Table 3.

Corporación de Reservas Estratégicas de Productos Petrolíferos Balance Sheet Statistics

	—Year ended Dec. 31—					
(Mil. €)	**2005e**	**2004**	**2003**	**2002**	**2001**	**2000**
Assets	1,067.7	765.9	768.2	767.9	699.2	563.2
Strategic reserves	1,045.9	756.7	755.3	755.5	678.6	556.7
Financial assets (short-term)	0.0	0.0	12.0	12.0	12.0	6.0
Tangible and intangible assets	21.8	9.1	0.8	0.4	0.4	0.4
Receivables	0.0	0.0	0.1	0.0	8.2	0.1
Cash	0.0	0.0	0.0	0.0	0.1	0.0
Liabilities	1,066.6	764.8	767.1	766.8	696.8	561.8
Own funds	69.6	66.6	62.2	56.3	52.0	41.7
Of which special reserve	36.8	36.8	36.8	36.8	28.0	0.7
Of which statutory reserve	29.7	25.4	19.5	15.2	13.6	8.9
Net profit	3.1	4.3	5.9	4.3	10.3	32.1
Long-term debt	671.5	671.5	671.5	672.3	624.0	497.0
Short-term debt	325.5	26.7	33.4	38.2	20.7	23.1
Provisions for risk	1.1	1.1	1.1	1.1	2.2	1.4

e—Estimated.

Chart 3

CORES Maturity Profile At Year-End 2005