

Full Analysis:

# Corporación de Reservas Estratégicas de Productos Petrolíferos (CORES)

07/20/2021

*This report does not constitute a rating action.*

## Major Rating Factors

### Key strengths

- Almost certain likelihood of timely and sufficient central government extraordinary support in the event of financial distress.
- Highly strategic role for the sovereign and Spain's economy, given its responsibility for managing the country's oil product reserves.
- Strong and stable regulatory framework, ensuring full coverage of costs, as has been the case during the COVID-19 pandemic.

### Key risks

- Lack of an explicit guarantee from the state.
- Limited asset diversification, given the nature of activities.
- Dependence on market prices and available capacity for storage, which could somewhat limit flexibility, although CORES can sell excess oil reserves and increase fees to members if needed.

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## Outlook

S&P Global Ratings' negative outlook on Spanish oil reserve management company CORES reflects that on Spain (unsolicited A/Negative/A-1).

## Downside scenario

We could lower our ratings on CORES in the next 12 months if we took a similar action on Spain. We could also lower our ratings on CORES if we believed that the entity's role for, and link with, the Spanish government had weakened, indicating a lower likelihood of extraordinary government support.

## Upside scenario

We could revise our outlook to stable in the next 12 months if we took the same action on Spain.

## Rationale

We regard CORES as a government-related entity (GRE). We believe there is an almost certain likelihood that CORES would receive timely and sufficient extraordinary support from the Spanish government in the event of financial distress. We therefore equalize our long-term issuer credit rating on CORES with that on Spain.

CORES operates under the supervision of the Spanish central government through the Ministry of Ecological Transition and Demographic Challenge, but with a distinct legal status and under private law. Our view of almost certain government support for CORES hinges on the entity's:

- Critical role for the government of Spain as an entity specifically formed to provide a key strategic public service on behalf of the Spanish government. CORES has an explicit mandate to monitor and maintain the level of Spain's oil reserves--virtually all of which are imported--and ensure that they are sufficient to cover the country's oil consumption needs for a legally determined number of days. After the reform of Spain's hydrocarbon law in 2015, CORES' role now also includes management of strategic reserves of gas, although this activity has yet to start and has been delayed due to the pandemic; and
- Integral link with the government of Spain, since CORES is controlled and supervised by the Spanish Ministry for Ecological Transition and Demographic Challenge (MITECO). CORES' chairman, as well as four of the 11 members of its board of directors, are appointed by the ministry. While the board normally makes agreements by simple majority, the ministry may exercise veto powers through CORES' chairman on any decision that it deems contrary to public interest.

**CORES manages the level of oil reserves in Spain on behalf of the central government, and will therefore remain crucial for the Spanish government.**

Spain is a member of the International Energy Agency (IEA) and therefore, as per its agreement obligations under IEA must maintain minimum stocks of different groups of oil products. CORES, created by the Spanish government in 1994 by royal decree, helps the country to comply with this requirement, sharing the responsibility for holding these minimum reserves with the sector's operators. CORES must, by national law and in line with EU regulation, maintain at any given time a stock of at least 42 days' worth of Spain's national oil product consumption. The remaining stock (to reach the national requirement of 92 oil consumption days) is held by the oil operators, retail distributors, and consumers of imported oil.

In 2021, there has been a temporary change affecting CORES' mandate. Due to the sharp decrease in oil consumption in Spain last year, a figure that determines the reserve obligations for 2021, CORES had accumulated large excess oil reserves. The ministry decided to temporarily change CORES' mandate, such that, from April 2021 until the end of the year CORES will maintain 50 days' worth of oil reserves rather than 42. At the same time, this change reduces the obligation of oil operators to 42 days from 50 days, thereby avoiding the accumulation of excessive reserves and optimizing costs systemwide. We expect the reserve requirements for CORES will revert to the original 42 days of consumption in 2022.

In 2015, a legal reform of Spain's law governing the hydrocarbon industry expanded CORES' role, allowing it to maintain gas reserves on behalf of market operators. The legal framework is yet to be developed within the ministry, and the fragmented parliament in Spain, and current COVID-19 situation, has delayed the process. However, in our view, this new responsibility reinforces CORES' mandate.

On top of these responsibilities, CORES also acts as a statistics hub of information related to oil and gas consumption. CORES actively maintains and manages this information, which is communicated to the market and other operators. This allows CORES to actively monitor any change in consumption patterns.

### **The central government of Spain provides ongoing support through a strong and stable regulatory framework.**

CORES operates under a regulatory framework where oil and gas operators must pay the necessary fees to fully cover its costs, including debt service. CORES does not receive funds from the government or benefit from an explicit guarantee of its liabilities. However, its framework has proven robust and a sign of support. The current legal framework allows CORES to demand extraordinary fees from operators if necessary, with authorization by the central government. Furthermore, we believe that if CORES were to be dissolved, the central government would take over its obligations.

All oil and gas operators authorized for distribution are legally obliged to be members of CORES and are charged monthly fees. Retail distributors and consumers of imported oil and gas products must pay monthly fees to CORES but do not have member status. Approximately 80% of CORES' annual fees in 2020 came from six members, including the two largest oil operators in Spain, Repsol (31%) and Cepsa (22%).

### **CORES' fee-setting framework helps to ensure sufficiency of revenue.**

CORES' funding comes from the monthly fees it receives from its members, which are set to cover all operating, financial, and administrative costs, including debt service. The monthly fee payments are calculated based on unit quotas per volume of product sold or consumed in the preceding month by each member. So far, and thanks to the conservative assumptions that CORES makes when calculating these fees, CORES has had annual fee surpluses in previous years.

When there are excess reserves, the board of directors has traditionally returned the related excess fees to its members. This happens at the end of the year, when it becomes clear that the initial budgeting would lead to excess fees. However, CORES calculates the revised fees with enough of a margin in case there is an unforeseen change in consumption patterns. These quotas are made official and legally binding by ministerial order. On the other hand, the board of directors could raise fees by up to a maximum of 5% in any given year if CORES' expenses are higher than projected, or if there are unforeseen circumstances that could put CORES' liquidity at risk. Moreover, if this were not sufficient, the government is entitled to authorize an extraordinary fee to the oil and gas operators, a mechanism that has been successfully implemented during the pandemic.

This framework was proven effective in 2020, when CORES was able to demand extraordinary fees from its members on short notice to cover the shortfall in revenue arising from lower sales of oil products. As a direct consequence of the pandemic's impact and related restrictions, the consumption of oil- and gas-related products plummeted. During 2020, oil operators sold about 19.5% less oil-related products than initially budgeted by CORES and which determined the initial fees they were charged in 2020. To address this gap, CORES and the Ministry of Ecological Transition and Demographic Challenge asked members to pay an extraordinary fee, which allowed CORES to fully cover its costs. The extraordinary fee was calculated with

conservative estimates of full-year consumption, ultimately leading to about €13 million in excess revenue that was later returned to operators.

This measure was approved by the Spanish government through a Ministerial order on May 27, 2020, and approved unanimously by CORES' board of directors. We believe this process demonstrates the strong framework under which CORES operates, and the timely administrative and political reaction from the central government to assist CORES under stressed conditions.

### **CORES could sell reserves to increase its liquidity and use the proceeds for debt repayment**

CORES has the ability to sell excess reserves if it deems necessary; it legally has to use the proceeds to repay its debt obligations. In compliance with this mandate, during 2021, CORES has already sold excess reserves for a gross amount of close to €150 million, the proceeds of which the entity has used to pre-amortize €95 million in debt. Additional excess liquidity will be factored in when deciding on CORES' financing policy regarding upcoming maturities.

CORES has €250 million in debt maturities to ICO (Spain's official financing institute) due in December 2021, which we understand the entity will refinance well in advance. In 2022, CORES has a €350 million bond maturing. We do not expect the entity should have any difficulty refinancing this maturity either, provided that market conditions remain favorable.

In addition to its liquidity reserves, CORES has €110 million in available credit lines. Additionally, with data as of May 31, 2021, we estimate CORES could sell additional excess reserves for a value of over €150 million, should it be necessary to meet its financial commitments. However, the value of excess reserves is subject to fluctuations arising from changes in consumption and global prices for petroleum products.

### **Related Criteria**

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

### **Related Research**

- Sovereign Risk Indicators, April 12, 2021
- Research Update: Spain 'A/A-1' Ratings Affirmed; Outlook Remains Negative On Fiscal And Structural Challenges, March 19, 2021
- Strategic Oil Reserve Manager CORES Outlook Revised To Negative After Similar Action On Spain; 'A/A-1' Ratings Affirmed, Sept. 22, 2020



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