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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

Strengths:

- There is an almost certain likelihood of timely and sufficient extraordinary central government support in the event of financial distress.
- CORES' role is highly strategic for the Spanish state and its economy, given its responsibility for managing oil reserves in Spain.
- CORES' legal framework and regulatory status is stable and strong, ensuring the full coverage of its costs, as has been the case during the COVID-19 pandemic.

Issuer Credit Rating

A/Stable/A-1

Weaknesses:

- There is a lack of explicit guarantees from the state.
- Asset diversification is limited, given the nature of CORES' activities.
- Dependence on market prices and available capacity for storage, which could somewhat limit its flexibility. Though this is mitigated by CORES' ability to sell excess reserves and increase fees to members if needed.

Outlook

The stable outlook on Corporacion de Reservas Estrategicas Petroliferas (CORES) mirrors that on Spain (A/Stable/A-1).

Downside scenario

We could upgrade CORES if we upgraded Spain, assuming no change to CORES' role for and link with the sovereign.

Upside scenario

We could downgrade CORES if we downgraded Spain or if we assessed that CORES' role for and link with the Spanish government had weakened, indicating a lower likelihood of extraordinary government support.

Rationale

We regard CORES as a government-related entity (GRE). We believe that 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 of 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 strategic public service on behalf of the Spanish government. CORES has an explicit mandate to monitor 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 period of time. 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.
- Integral link with the government of Spain, since CORES is tightly controlled and supervised by the Spanish Ministry for Ecological Transition and Demographic Challenge. CORES' chairman is appointed by the ministry, as well as four of the 11 members of its board of directors. While the board 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 and gas reserves in Spain and on behalf of the central government and therefore will continue to be crucial for the Spanish government

CORES, created by the Spanish state in 1994 by royal decree, is a member of the International Energy Agency and therefore must maintain minimum stocks for different groups of oil products. CORES shared the responsibility for holding these minimum-security reserves with the sector's operators. CORES must, by national law and following with 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) is held by the oil operators, retail distributors, and consumers of imported oil.

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 with 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 source of information related to oil and gas consumption. CORES manages actively 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, nor does it benefit from any explicit guarantee of its liabilities. However, its framework has proved to be 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 2019 came from six members, including the two largest oil operators in Spain, Repsol (31%) and Cepsa (23%).

CORES' fee setting policy helps to ensure sufficiency of revenues

CORES' funding comes from the monthly fees it receives from its members. These fees 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 takes when calculating these fees, CORES has had annual fees surpluses over the past years. When there is an excess of reserves, the board of directors has traditionally decided to return excess fees to its members, as a signal of willingness to contain fee levels. This happens at the end of the year, when it becomes clear that the initial budgeting will lead to excess fees. However, CORES calculates these revised fees with enough margin of security in case there should be 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 up to a maximum of 5% in any given year if CORES' expenses are higher than projected, or if there is any 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 COVID-19 pandemic.

During the pandemic, CORES has charged operators an extraordinary fee to ensure full coverage of expenses in 2020

As a direct consequence of COVID-19 and the restrictions imposed during the state of emergency, consumption of oil- and gas-related products has decreased significantly. As a result, CORES' operators have sold about 36% less oil-related products in April-May, and CORES estimates about 11% less gas-related products in 2020, compared with CORES' previous estimates used to build the budget and the level of fees to be charged to operators in 2020. This translated into a decrease of CORES' revenues of about 60% in the month of May, according to the Ministry's order published on May 29, 2020. To address this effect, CORES and the Ministry of Ecological Transition and Demographic Challenge have asked members to pay an extraordinary fee. This will ensure CORES' budgetary balance in 2020, by compensating for the shortfall in revenue versus the initial budget for the period between May and September 2020. This measure was approved by the Spanish government through a Ministerial order on May 29, 2020, and approved unanimously by the board of directors. The calculated extraordinary fees are based on CORES' estimate of expected deficits for the year, under a conservative scenario. These will be charged to operators on a monthly basis until September, when CORES and the board routinely reassess fees each year. Should it be necessary, CORES could impose further extraordinary fees for the remainder of the year, or conversely adjust fees down, if warranted. We believe this process proves the strong framework under which CORES operates, and timely support from the central government to 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 would legally have to use the proceeds to repay its debt obligations. As of June 30, 2020, we estimate CORES could sell its excess reserves for a value of over €120 million. However, the value of excess reserves is subject to fluctuations arising from changes in consumption and global prices for petroleum products.

CORES' €125 million of debt due 2020 was refinanced in 2019 at more beneficial terms and with a longer maturity date, now in 2028. CORES' next maturities in 2021 and 2022 are €250 million and €410 million, respectively. We expect CORES will refinance these maturities through bank loans or by issuing bonds in the financial markets.

Moreover, CORES has renewed its credit lines for €115 million, and we expect them to remain at this level for the next two years.

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: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Sovereign Risk Indicators, July 14, 2020
- Spain, March 20, 2020
- Research Update: Strategic Oil Reserve Manager CORES Upgraded To 'A' Following Similar Action On Spain; Outlook Stable, Sept. 24, 2019

Ratings Detail (As Of July 29, 2020)*

Corporacion de Reservas Estrategicas de Productos Petroliferos

Issuer Credit Rating	A/Stable/A-1
Senior Unsecured	A

Issuer Credit Ratings History

24-Sep-2019	A/Stable/A-1
27-Mar-2018	A-/Positive/A-2
05-Apr-2017	BBB+/Positive/A-2
06-Oct-2015	BBB+/Stable/A-2

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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