Marcos y Asociados

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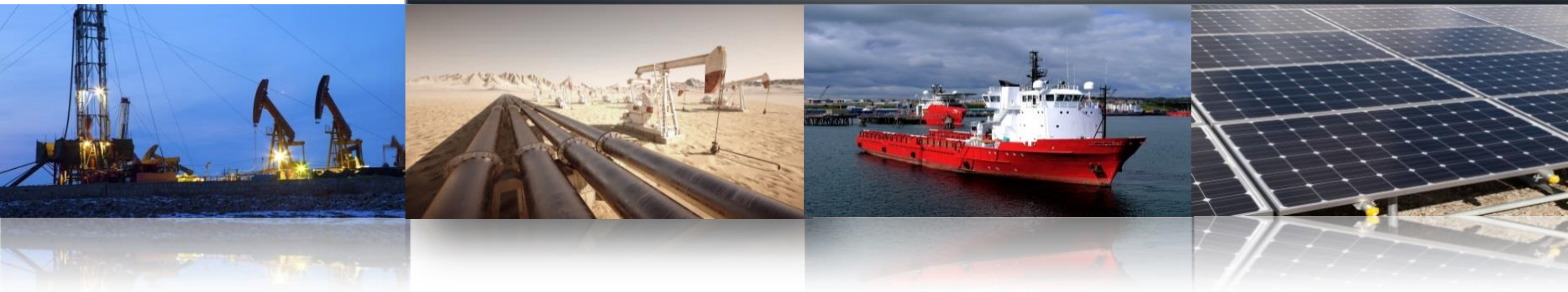
Energy Monthly News

March, 2020



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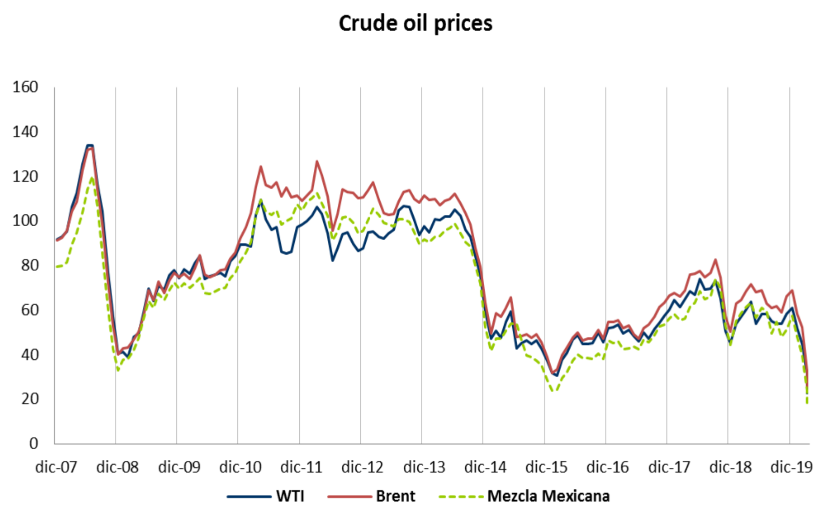


Crude oil Price* US/BD	WTI 24.01 BRENT 27.15 MME 16.06
NG price* US/MMBTU	Henry Hub 1.67
Mx crude production MMbd	1.721 *(Feb-20)*
Mx NG production MMpcd	4,993 *(Feb-20)*
US crude production MMbd	12.77 *(Dec-19)*
FX Rate**	25.11

** 24/03/2020 **24/03/2020*
Source: EIA. El Reforma, Pemex, Banxico, and CNH

Oil & Gas

Pemex downgraded to 'BBB' on similar action on Mexico, outlook negative; stand-alone credit profile cut to 'ccc+' – *S&P*

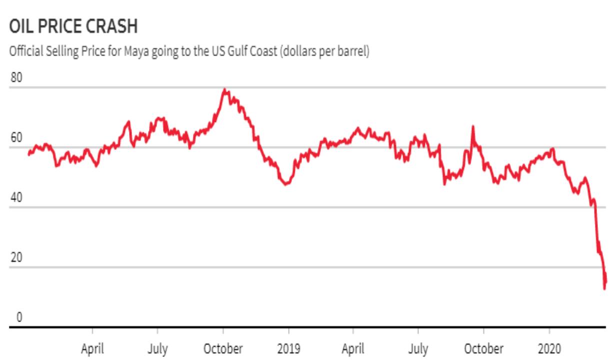
- Recurring government aid to Mexican oil company Pemex over the last twelve months reinforces our assessment of an almost certain likelihood of extraordinary government support if the company were to run into financial difficulties. Therefore, the ratings on Pemex continue to mirror those on the sovereign.
- On March 26, 2020, S&P Global Ratings downgraded its global scale foreign currency and local currency ratings on Pemex to 'BBB' and 'BBB+' from 'BBB+' and 'A-', respectively, and maintained the negative global scale rating outlook, following a similar action on the sovereign. In addition, we affirmed our national scale 'mxAAA/mxA-1+' issuer credit ratings on the company. The outlook on the national scale rating is stable. We also downgraded our issuer credit ratings on Pemex's subsidiaries to 'BBB' (foreign currency) and to 'BBB+' (local currency) from 'BBB+' and 'A-', respectively.
- Lower oil and natural gas prices anticipated over the next two years will jeopardize the execution of Pemex's business plan, because weaker cash flow will limit the ability to fully fund its multi-annual capital investment needs. In this context, we see limited room for Pemex to improve its very weak credit metrics any time soon. In addition, low cash flow generation prospects and an extended period of adverse financing conditions could gradually tighten the company's liquidity. Therefore, we have revised downwards our stand-alone credit profile on Pemex to 'ccc+' from 'b-'.

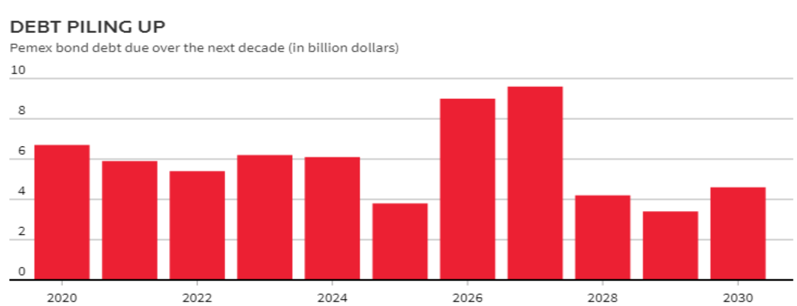
We consider that our assessment has been reinforced over the last fifteen months through recurring government aid to Pemex in the form of capital contributions, legal amendments to alleviate the company's tax burden, the monetization of certain assets, and close collaboration to deter fuel theft. Although these actions are insufficient to fully address Pemex's funding needs, they underpin the track record of government support to the company. Another factor captured in our assessment is the reversal in Mexico's energy policy under the current administration, which repositions Pemex at center stage and curbs the participation of private players in the domestic energy sector. In our view, it has become evident that this plan increases the government's incentives to support Pemex, when needed, because the administration aims to enlarge the role of the state in the energy sector, which it has deemed strategic. The negative outlook on Pemex mirrors that on the sovereign and reflects our view that the close relationship between the company and the sovereign will remain unchanged in the next couple of years.

Mexico's challenge – *Reuters*

Mexican President AMLO needs to find more than $30 billion until the end of his term in 2024 to meet bond payments of national oil company Pemex but the price of its main export crude has crashed. The perception Pemex may not be able to meet payments raises the likelihood a second rating agency strips its investment grade rating this year. This could hit the cost of borrowing for the government.

Pemex CEO Octavio Romero vowed to slash administrative costs and freeze hiring, acknowledging that the company's oil price hedging strategy would not make a dent in the mounting debt problems. Few in the industry think Romero's measures will suffice, yet options are limited, with investment appetite low as the world lurches towards recession.





In the past, the government has propped up Pemex with cash injections, but government finances are tight and it will be harder than ever for the finance ministry to lower the company's high tax burden. Pemex refinanced more than USD $29 billion in bonds last year, a strategy that created some breathing space and was intended to create cash flow for investments in production.

But raising capital again will be daunting during the economic chaos of coronavirus, as investors chose safe-havens over riskier bonds. AMLO also threw Pemex lifelines in the form of cash injections and tax breaks last year. However, it still had more than USD $105.2 billion in financial debt at the end of the year, and an additional USD $77.3 billion in pension obligations.

Most Pemex bond yields were above double digits. Its highly traded 2030 bond traded at 71.5 cents on the dollar at the close on March 20, with a yield of 11.80%.

Mexican oil output falls in February – *CNH*
Mexico's oil production reached an average of 1.721 million barrels per day in February, compared to January average output of 1.724 million barrels per day. In the month of February, the production of the contracts reached 107.2 thousand barrels per day. Currently, 53% of the national crude oil production comes mainly from 5 fields, Maloob, Zaap, Ayatsil, Xanab and Ku.

Crude oil production *(Feb)*	Mbd
Pemex	1,614.40
Contracts	107.2
Total	**1,721.60**

Talos Energy announces additional budget reductions – *Press Release*
Talos Energy announced updated full year 2020 financial guidance, inclusive of USD $170.0 million of reductions in capital, operating and G&A expenses.

Talos continues to expect to generate positive free cash flow in 2020 despite the current commodity environment. The Company's updated guidance reflects investments in infrastructure-led, short-cycle projects that were previously committed to and that are focused on lowering the lifting cost structure of Talos's assets by adding incremental barrels through existing fixed-cost offshore production facilities, resulting in an increased value of the asset base. Given the ability to utilize existing infrastructure, Talos believes these high margin, low breakeven investments are economic even in the current commodity price environment. Also included in the guidance is a limited, but unchanged, portion of Talos's budget dedicated to the front-end engineering and design "FEED" work related to Zama project offshore Mexico.

Production sales volumes for 2020 are expected to be 23.3 – 24.6 million barrels of oil equivalent, which represents an average daily production of 63.7 – 67.1 thousand barrels of oil equivalent per day (less than 5%) reduction from the original 2020 full-year guidance due to deferred projects. Talos continues to maintain its robust hedge book. As of March 23, the Company had approximately 11.9 million barrels of oil hedged for 2020, representing 70% of the mid-point of guided oil volumes, at a weighted average WTI price of $51.53 per barrel. Talos's updated 2020 capital expenditures guidance represents approximately a 34% reduction from the 2019 investments in the same asset base.

		Original Guidance		Reduction	Updated Guidance	
		Low	High		Low	High
Production	Oil (MMBbl)	17.0	18.0	-0.6	16.4	17.4
	Natural Gas (Bcf)	35.0	36.0	-2.0	33.0	34.0
	NGL (MMBbl)	1.6	1.7	-0.2	1.4	1.5
	Total (MMBoe)	**24.4**	**25.7**	**-1.1**	**23.3**	**24.6**
	***Avg Daily Production** (MBoe/d)*	***66.8***	***70.2***	***-3.1***	***63.7***	***67.1***
Cash Expenses *(US$ million)*	Cash Operating Expenses[1]	$300	$325	($20)	$280	$305
	G&A[2]	$70	$75	($10)	$60	$65
Capex *(US$ million)*	Capital Expenditures[3][4]	$520	$545	($140)	$380	$405
	Total Expenses *(US$ million)*	**$890**	**$945**	**($170)**	**$720**	**$775**

1) Inclusive of all Lease Operating Expenses and Workover and Maintenance
2) Excludes non-cash equity-based compensation
3) Includes Plugging & Abandonment
4) Excludes acquisitions

Magseis Fairfield wins Mexico OBN survey – *Magseis Fairfield Press Release*

Magseis Fairfield has secured a deepwater ocean bottom node (OBN) project with an undisclosed client in the Mexican sector of the Gulf of Mexico. This is the first deepwater OBN survey in Mexico following the 2013 Energy Reform, with work scheduled to start in the third quarter of 2020. The survey will be carried out in water depths of 2,000 to 2,600 meters, and should take approximately 60 days.

The award adds further to the backlog for Magseis Fairfield's ZXPLR crew, led by the REM Saltire node handling vessel.

Mexico's Pemex highly vulnerable to oil prices below $20/bbl – *Fitch*

Pemex is increasingly vulnerable to low crude prices as the fast-spreading coronavirus outbreak erodes demand and sends markets tumbling. Fitch called Pemex, the "most vulnerable" among its peers in Latin America, warning it will likely need more government support and higher revenue from its refining business to weather the fall in prices.

"At the current Mexico's crude basket price of below $20 per barrel, Pemex upstream business (exploration and production) does not generate enough cash flow to cover operational and financial costs," it said. Mexico's oil basket plummeted to $14.5 per barrel, its lowest level in 18 years.

Pemex has been on the verge of losing its coveted investment grade rating since last spring. That is when Fitch Ratings became the first agency classifying Pemex bonds worth tens of billions of dollars at speculative grade, or junk. Investors widely expect Moody's Investors Service, which rates the bonds just one notch above junk and has them on a negative outlook, to downgrade the bonds also, which would give Pemex bonds an official status as junk. The statement did not mention ratings changes. Fitch said Pemex's liquidity position is currently adequate as a result of low amortizations and available credit lines, but its weak standalone credit profile limits its resilience to the downturn in oil prices. The agency estimates Pemex's full-cycle costs before taxes at approximately $50 per barrel and more than $80 per barrel after taxes.

Total refuses rights to deep water block in Mexican Gulf – *CNH*

CNH approved a request by Total and ExxonMobil consortium to give up its exploration and production rights to a deep water block in the southern Gulf of Mexico. The two firms won the offshore block, part of assignment CNH-R01-L04-A2.CPP/2016, in 2016's auction Round 1.4. Total and ExxonMobil informed to CNH that it was relinquishing its nearly 3,000 km² field off the coast of Tamaulipas, because its well drilling campaign in ultra-deepwaters late last year turned up a dry well. It was the first well drilled in ultra-deepwaters in offshore Mexico related to the partial privatization of the oil sector from 2013-2018.

Handing back the site, the mandatory fine the companies will have to pay into Mexico's oil fund is USD $21.2 million for failing to comply with its contract's minimum exploration work requirements.

Mexico to invite oil and gas investment, no auctions for now – *Reuters*

Mexico will soon invite private firms to invest in oil and gas projects to help a flagging economy hit by the fallout of coronavirus, Finance Minister Arturo Herrera said, but cautioned energy auctions were not on the cards for now. Herrera said a long-awaited energy plan will be unveiled soon that will detail where and how much private firms can invest.

Under President AMLO, Mexico has pursued a more statist approach to the energy sector and suspended auctions of oil fields. AMLO said the energy plan could be unveiled in March, after weeks of delays. The balance of public and private investment the plan will aim for has not been clear because of differences of opinion in the cabinet over energy policy. Some members of the government believe attracting more private capital is vital for lifting growth and that restarting auctions would send a strong message to investors that Mexico is open for business.

Herrera has in the past signaled the issue should be reconsidered, despite the ongoing suspension. But Herrera said even auctions for joint venture projects with state oil company Pemex were not viable, after a rout in oil markets this week caused by a drop in fuel demand from the coronavirus outbreak and the collapse of a production cutting deal between major producers.

CNH approves modifications to Eltreinta development plan – *CNH*

CNH approved to Pemex the modification to the development plan for the assignment A-0340-M-Campo Eltreinta. The Eltreinta land field is located 160 km from the Veracruz and has a depth of 2,300 meters. Pemex requested the modification due to the need to expand the number of wells to be drilled, decrease the approved investment, modify the volume of hydrocarbons to be produced and change the gas measurement point. The activities that the operator will carry out include the drilling of 13 new wells, 11 major repairs, 672 minor repairs with an investment of USD $230.5 million and operating expenses of USD $153.8 million, a total investment of USD $385 million. Pemex plans to recover 14.4 million barrels and 105.4 billion cubic feet of gas.

Pemex receives first payout from oil hedge amid low crude prices – *Bloomberg*

Pemex received its first payment from its annual oil hedge, as prices fell the most in three decades amid a producer battle for market share, and the fast-spreading coronavirus.

Pemex protected its 2020 oil exports at an average of $49 a barrel, receiving the first payment for the month of February. Pemex hedged 234,000 barrels a day in 2020, a little over one-fifth of its crude oil exports, which averaged 1.1 million barrels a day in 2019, according to a recent filing to the Mexican stock exchange. That is a 24% reduction in volume they hedged compared with 2018.

Pemex set to struggle with lower oil prices due to coronavirus – *Bnamericas*

Oil spot prices dived by more than 20%, triggering a new wave of sales on stock markets due to fears that coronavirus will affect world economic growth. Pemex and even the national budget are uniquely vulnerable to sustained declines in global oil prices.

Over the weekend, Saudi Arabian NOC Aramco, now the most valuable listed company in history cut its official oil prices. In tandem, the country's government announced it was planning to increase oil output. The move was an unprecedented salvo against Russia, after Moscow last week refused to go along with OPEC plans for price cuts amid concerns that the coronavirus was quickly eroding demand for oil.

Now, Russia's refusal to back OPEC's plans and Saudi Arabia's historic response has ignited a price war between the world's second- and third-largest oil producers, with cascading effects on smaller producers like Mexico. "An economic slowdown will throw the price of oil to barely profitable levels, and that, including the price war between Saudi Arabia and Russia, could be really negative for Pemex," Luis Gonzali, vice president and senior portfolio manager at Franklin Templeton Investments in Mexico City.

While Pemex contracted an oil hedge for part of its production, it did not cover it all. The Mexican government's entire budget, meanwhile, pegs revenue based on an average of US$49 a barrel through 2020. However, the impact on oil prices would be only one of many headwinds that Mexico could face. A weaker peso in currency markets would likely buoy Mexican exports, but a slowing economy would mean lower revenue for the government.

Only four of those 20 fields are producing oil. And even if all of them were productive, the 20 fields would have a breakeven cost of USD $52 a barrel, according to an analysis by Natural Gas Intelligence last November. For Pemex, the short-term threat is that it has not hedged its total production, leaving it somewhat exposed if global oil prices remain low throughout the year. Meanwhile, the government is facing mounting pressure to combat public health concerns related to the coronavirus alongside broader economic impacts of fewer tourists and lower oil prices.

U.S., Canada, European nations meet to discuss concern over Mexico energy policy – *Reuters*

The United States, the European Union, Canada and six European nations have held joint talks on concerns over Mexico's energy policy, as President AMLO pushes for a bigger role for the state in the sector.

The unusually broad diplomatic encounter is a measure of how AMLO's break with the energy policy of the previous government is worrying economies that have traditionally been some of Mexico's biggest foreign investors.

U.S., Canadian and European officials privately voice concern that Mexico's energy policy is eroding the legal foundations of contracts worth billions of dollars with the previous administration, in what they fear is a creeping squeeze-out of their interests. Mexico's government denies it is undermining those deals, but says prior contracts were often damaging to the country, and has sought to renegotiate the terms of some.

AMLO has committed himself to strengthening the state's role in the energy sector, arguing that past market liberalization and privatization of other industries deepened chronic inequality in Mexico and encouraged corruption. AMLO has put the brakes on that liberalization process, saying it has not yielded benefits for Mexico.

Power/Renewable Energy

Enel locks 10-year wind, solar PPA with Heineken Mexico - *Expansión*

Enel Energía Mexico and Heineken have signed a ten-year power purchase agreement "PPA". Under the contract, Heineken Mexico will be getting 28.8 GWh of green power each year for its operations at its brewery in Meoqui, Chihuahua. The 100% clean electricity will come from a portfolio of wind and solar projects originating from Enel's renewables arm Enel Green Power. The PPA is in line with the company's plans to reach a 66% renewables share in energy consumption in 2020. By 2030, the beer maker seeks to push the renewables share to 100%.

Enel Green Power Mexico manages more than 2,660 MW of renewables in the country. This capacity is split between 1,303 MW of wind, around 1,308 MW of solar and 53 MW of hydropower. The renewables company is also finalizing close to 320 MW of wind projects.