May, 2023

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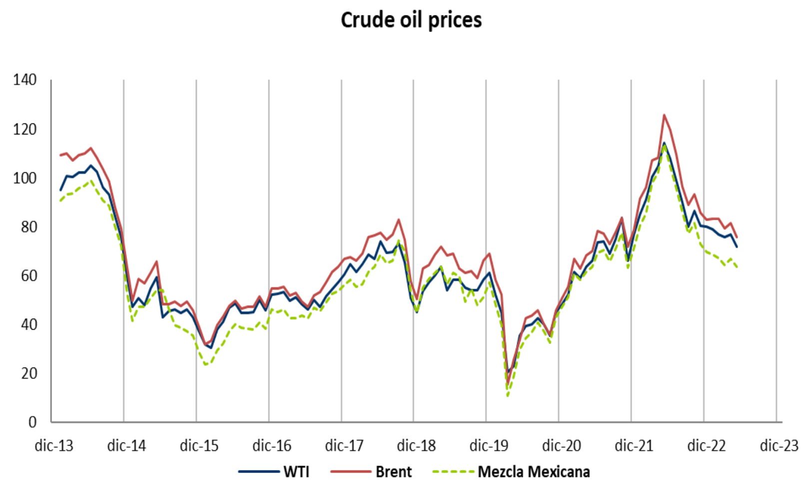
This month in review

* 29/05/2023

MME US/BD*	66.21
MME US/BD* PEF SHCP	68.70
Dif. MME vs. MME PEF SHCP	-2.49
NG price HH* US/MMBTU	2.35
Mx crude production MMbd – *April*	1.66
Mx NG production MMpcd – *April*	4,400
US crude production MMbd - *February*	12.48
FX Rate*	17.56



Source: EIA. El Reforma, Pemex, Banxico, and CNH

Expert Contributor | Luis Miguel Labardini, Senior Partner at MyA

Pemex´s financial outlook 2023 – *Business Mexico News*

2023 so far has been a roller-coaster of statements by both the Ministry of Finance and Pemex Corporation. The president of Mexico himself expressed at one point the idea that Pemex's debt should be converted to sovereign debt, highlighting the fact that its excessive debt is the most compelling problem the state oil and gas company has to face. It must be said that the Pemex debt problem was not created by this administration. During the Peña Nieto administration, Pemex's debt grew from US$50 billion to more than USD$100 billion. In the second quarter of 2020, Pemex had to face the perfect storm, with the pandemic and a historic collapse in the price of crude oil, resulting in Pemex losing its investment grade. Fitch and Moody's lowered Pemex's rating to "junk," with only Standard and Poor's maintaining the investment grade for Pemex, based on the assumption that the support of the Mexican Federal government would not be withdrawn.

According to Pemex's 1Q23 report, the company's debt amortization schedule includes payments of US$4.6 billion in 2023, US$10.9 billion in 2024, US$4.9 billion in 2025, and US$8.8 billion in 2026. The Ministry of Finance recently announced that Pemex will delay the payment of the DUC (Derecho de Utilidad Compartida, or Right of Shared Utility) royalty, which would free resources to partly amortize payments in 2023. This measure should bring some comfort to the markets; however, it is likely that further measures will be required for Pemex to take care of accounts payable to contractors.

Pemex had been receiving significant direct transfers and other financial aid from the Federal government in the last two years. However, assuming that the price of crude oil would remain at the high levels of 2022, the Federal budget for 2023 did not consider any further financial assistance to Pemex. For fiscal year 2022, Pemex was able to produce profits after a long period of losses. During the first quarter of 2023, Pemex produced positive numbers in spite of lower prices for crude oil in international markets.

Pemex has a very good exploration and production operation, but it has to deal with the debt problem and with an inefficient refining operation. In fact, during the first quarter of 2023, Pemex ranked only third in the world in terms of EBITDA as a percentage of sales. This is no minor achievement. All other companies in the ranking are publicly traded companies, making PEMEX the only state-owned company to make the Top 10 in this category. It must be clearly understood that Pemex is too big to fail, and that aside from the debt issue, Pemex does have a very promising future. It must be also understood that the structural problem requires a long-term structural solution.

The president hinted at the possibility of turning Pemex's debt into sovereign debt, but the impact of such a measure on the sovereign´s own investment grade would be very harmful. A structural solution would have to include a renegotiation of existing debt, based on a commitment on the part of the government to capitalize the entity in a way that would bring the balance sheet to a healthy state.

Throughout Pemex's history, government after government forced the company to acquire additional debt, mainly because of the very high dependence on oil revenues to finance public expenditure. Today is a good time to act, since the Mexican economy has grown and diversified in a way that oil revenues are not as critical for government finances as they were in the past. I am a strong proponent of an IPO for Pemex, but an IPO would require a profound restructuring, for which both the government and creditors must agree on the Pemex that will emerge from such restructuring.

Pemex must take advantage of its strength in exploration and production, and rethink its strategy regarding downstream operations, which are a burden to the entity. Most observers would point out that downsizing downstream at Pemex would never take place under this administration, because self-sufficiency in fuel production is paramount to the López Obrador government. However, it must be said that even considering that from an energy security and balance of payments perspective, the government perspective might have some merits, it is definitely damaging for the future and long-term viability of Pemex.

Refining is a complex business, with thin margins, high volatility and seasonal behavior. Mexico is ill-prepared to have a competitive refining sector, among other things because there is no storage capacity for all practical purposes. Of course, there are success stories in refining throughout the history of the industry, such as Jurong Island in Singapore, but that would require a carefully designed strategy that would include the participation of the private sector. In any circumstance, these subjects are so important for the Mexican oil and gas sector that they should be openly discussed without prejudice regarding what should be the optimal solution.

Talos Energy stake in Zama, with Grupo Carso – *Talos Energy Press Release*

Talos Energy announced that Zamajal, S. A. de C.V., a wholly owned subsidiary of Grupo Carso, has agreed to acquire a 49.9% interest in Talos's Mexican subsidiary, which holds the Company's 17.4% stake in Zama. Talos will remain the controlling shareholder of Talos Mexico. The transaction is expected to close within the third quarter of 2023, as is subject to approval by COFECE.

- Purchase price of $124.75 million for the 49.9% stake, implying a minimum valuation of approximately $250.0 million for the full 17.4% stake in Zama, potentially increasing to $262.50 million if certain milestones are reached.
- $74.85 million will be paid at closing, with the remaining $49.90 million due at first production.

Talos announced in March 2023 that the Zama Unit Development Plan was submitted to CNH for formal approval. Additionally, an Integrated Project Team comprised of individuals from all four Zama Unit Holders was established to manage the development and operation of Zama going forward. Talos will co-lead the planning, drilling, construction, and completion of all Zama wells as well as the planning, execution, and delivery of Zama's offshore infrastructure.

Mexico's Olmeca refinery likely to miss mid-year start target – *Bnamericas*

Olmeca oil refinery is likely to miss its mid-year startup date, according to an analyst. The refinery was expected by the authorities to begin operations at half capacity on July 1 and reach nameplate capacity in December, which would see it processing 340,000b/d of crude.

But this schedule is highly unlikely to be met given the project's current advancement, said Óscar Ocampo, energy expert at competition think tank IMCO. "The refinery still has big infrastructure and connectivity issues which, given the little information available, are not likely to be solved in the next two months".

The highly ambitious project has been marred by controversy from the start, when the energy ministry dismissed internal estimates that the project would cost USD $15bn-17bn and budgeted USD $8bn for construction. The authorities also ignored the concerns of environmental activists and state agencies like petroleum fund IMP, which said the area's ecosystem was too valuable to host a project of Olmeca's scale. Pemex's latest internal audit shows that, as of 2022, the project had involved total costs of USD $16bn, and at the end of Q1 this year had hired services totaling USD $16.9bn, more than double the initial government estimates.

Pemex to invest additional USD $5.5bn in Ayatsil production – *CNH*

Pemex will invest an additional USD $5.5bn to fulfill the promise of its Ayatsil discovery off the coast of Campeche bay through a secondary recovery strategy. The company's development plan has significantly underperformed, extracting 43Mb less oil than originally estimated in 2022, when Ayastil was expected to produce above 150,000b/d – roughly 50,000b/d more than its current output.

CNH attributed the situation to pandemic-related logistics hurdles, which forced a slowdown in the spudding calendar. The reservoir's lower-than-expected pressure, which Pemex intends to increase through water injection, was also cited as a factor.

Pemex's updated development plan, which involves total investments of USD $12bn, seeks to steadily ramp up production to reach 150,000b/d by 2030. The plan almost doubles the originally expected investment to extract only 6% more oil than the previous estimate. The strategy involves spudding five new water injection and 13 production wells, with peak output expected around 2028-2030.

Pemex faces liquidity challenges – *Moody's*

Seven out of 30 Mexican companies analyzed by the rating agency Moody's, including Pemex, reported insufficient liquidity to cover their short-term debt maturities until 2024. Moody's pointed out that higher interest rates and weaker earnings are making the capital structures of some companies increasingly unsustainable. Approximately USD $32 billion in debt from Pemex were set to mature within the next 24 months, starting from December 2022. For the rest of the year, Pemex has to pay USD $4.6 billion, but according to the international rating agency Moody's, the company does not have sufficient liquidity to meet its debt obligations by 2024. "Pemex has weak liquidity and relies heavily on government support". The agency specified that Pemex has committed but unused credit lines amounting to USD $9.5 billion.

In July of last year, Moody's downgraded the Mexican company's rating to B1, categorizing its credit quality as "junk." Pemex remains the most indebted in the world, and its financial indebtedness is larger than that of Shell, BP, and Exxon combined. As of the end of the first quarter of this year, Shell's debt amounted to USD $44.2 billion, while the British company BP closed at USD $21.232 billion, and Exxon concluded the first three months of the year at USD $39.15 billion. The combined debt of these three oil companies amounted to USD $104.582 billion, USD $2.805 billion less than that of Pemex.

Pemex sets upstream capex budget increase for 2023 – *Business Mexico News*

Pemex has announced a significant increase in its upstream CAPEX budget for 2023. The budget has been set at MX$240 billion (USD $13.4 billion), up from MX$162 billion (USD $9.05 billion) in 2022. These investment plans were disclosed in Pemex's latest annual report, which was submitted to the US Securities and Exchange Commission in late April.

A major portion of the budget, amounting to MX$44.4 billion (USD$2.48 billion), has been allocated to the offshore Ku-Maloob-Zaap complex. This represents nearly double the amount budgeted for the complex in 2022. The second-highest allocation in the upstream capital budget for 2023 is for the onshore Ixachi natural gas and condensate field. This field has been crucial in maintaining Mexico's gas and liquids production. Pemex has assigned a CAPEX budget of MX$19 billion (USD $1.06 billion) to Ixachi, a significant increase from the MX$5 billion (USD $287 million) allocated in the previous year. In March, Ixachi stood as Pemex's second-leading natural gas producing field, while the top spot was held by the onshore Quesqui field.

In addition, the budget for the development of Quesqui in 2023 is MX$11.5 billion (USD $643 million), a decrease from the MX$12.9 billion (USD $722 million) allocated in the previous year. Other prominent projects in this year's CAPEX budget include the offshore Ek and Balam fields, collectively referred to as Ek-Balam. Additionally, the state-owned company plans to nearly double its investment at Ek-Balam to MX$14 billion (USD $784 million) this year. Furthermore, for the joint development of the Lakach deepwater gas field with New Fortress Energy, Pemex has designated a capital expenditure of MX$689 million (USD $38.6 million) for this year.

Pemex in talks to pay KKR $320 million for fuel-import terminal – *Bloomberg*

Pemex is in advanced talks to buy KKR & Co.'s Monterra Energy fuel-storage terminal in Tuxpan, Veracruz, in one of the latest blows to Mexican energy liberalization that ushered in a wave of foreign investment. Pemex, is planning to pay USD $320 million for the 2.2 million-barrel import terminal. A Monterra representative declined to comment.

KKR's Mexican subsidiary, Monterra Energy, founded after the energy reform of 2014 has faced different obstacles in light of changes in regulation carried out by the current administration. Monterra's 2.2MMb fuel import terminal was closed for almost a year after it was inspected in 2021. The facility was closed at gunpoint on Sept. 14, 2021, by Mexican regulatory authorities and the National Guard. Since then, it has not been allowed to operate.

A year later, February 2022, the company threatened to sue Mexico under international arbitration. Monterra Energy notified the Mexican government of its intention to launch international arbitration under NAFTA and USMCA for the suspension of operations in Tuxpan, Veracruz. This was another instance of discontent related to Mexico's violation of USMCA agreements concerning energy policy. Monterra investors seek USD $667 million in compensation, plus interest and legal costs.

At the time, Monterra Energy issued a public statement making it clear that there was no legal reason for this closure, since the terminal had been fully compliant with all standing SENER regulations.

Shell, Chevron abandon projects after failed exploration – *Forbes*

Shell and Chevron, announced their decision to withdraw from projects in the country due to the lack of commercially viable hydrocarbon reserves. Shell, has started the process of relinquishing two contractual areas located in the deep waters of the Gulf of Mexico. "The companies indicated that the contract area, Max-1XP had limited hydrocarbon potential due to insufficient thickness and immaturity, making oil and gas production economically unviable," said Valeria Bautista, Legal Representative, CNH.

A similar outcome was observed at the Alux-1EXP well, which revealed a restricted presence of reservoirs and thermal immaturity, further impeding production possibilities. These abandoned assets are situated in the Cuenca Salina oil province, offshore Tabasco and Campeche, and had a 35-year license.

Pemex pledges USD $80 million to reactivate gas processing plant – *Bnamericas*

Pemex will invest 1.4bn pesos (US$78.5mn) to reactivate a gas processing plant in Cotaxtla, Veracruz. The overhaul will increase processing capacity from 10Mf3/d of gas to 110Mf3/d, CEO Octavio Romero was quoted as saying by local press. A further expansion could take capacity to 200Mf3/d. The terminal, which is 42 years old and fell into disrepair, will be used to process gas from Pemex's flagship Ixachi field, which is leading natural gas production growth in the country.

Power/Renewable Energy – Mexico

Controversy over combined cycle in CELs – *Expansion*

CRE issued an agreement that sparked controversy regarding green energy, as it categorizes natural gas generation in combined-cycle power plants as fuel-free energy, thereby approving it for Clean Energy Certificates (CELs). While the move is intended to promote cleaner energy sources, critics argue that it may artificially inflate the proportion of clean energy in the electricity system.

CELs were introduced in 2014 as part of the government's efforts to drive the decarbonization of the energy sector and increase the share of non-fossil fuel electricity from 20% in 2018 to 35% by 2024. Over the years, the program has imposed annual incremental obligations on energy consumers to encourage the adoption of cleaner energy technologies. However, natural gas combined-cycle generation was initially overlooked as a recognized technology for reducing greenhouse gas emissions. The Mexican Solar Energy Association and the Mexican Wind Energy Association have raised objections, asserting that this inclusion may not accurately reflect the true carbon footprint associated with such generation methods. They argue that considering natural gas as fuel-free energy and awarding CELs could undermine the integrity of the program and lead to an artificial inflation of the clean energy share in the electricity system.

Queretaro wind farm will begin operations in June 2023 – *Business Mexico News*

Huimilpan’s wind farm in Queretaro will soon begin operations, after a series of technical tests and the approval of permits by CRE. The facility will boast a maximum capacity of 30MW and will be able to provide electricity to nearly 30,000 households in the area.

Mauricio Reyes, Director, Queretaro Energy Agency, stated that the wind farm is in its testing phase and is estimated to begin operations in June 2023. Moreover, given that the complex was inactive for a couple years, it must also go through maintenance processes. In November, 2017, the government of the state announced that Huimilpan’s wind farm, located in San Pedro, would begin operations in 2018.

However, the opening had been delayed until recently due to pending permits. "The farm is still in the testing stage, which means it is not delivering energy to the system yet. After so much time abandoned, a complex of this nature has to undergo maintenance to ensure its efficiency,” Reyes said. About USD $55,870.8 were invested in the construction of the complex, which will have a generation capacity of 30MW and provide electricity to around 30,000 households.

Oil & Gas - LATAM

Ecopetrol, Repsol find heavy oil in central Colombia – *Bnamericas*

Ecopetrol and Repsol have announced the discovery of heavy crude oil at their Tinamú-1 exploration well in central Colombia. Drilling reached a total depth of 7,832ft and tested for hydrocarbons in the K1 operating formation at a depth of 7,500ft, according to an Ecopetrol statement. Initial tests produced 7,329b of oil with a water cut of 1%. "This well has a strategic location, because it is close to the Ecopetrol fields: Castilla and Chichimene in the department of Meta, where a large part of Colombia's oil production is extracted," Colombia's state-run oil company said.

The Tinamú area forms part of the Llanos basin's CPO 9 block, in which Ecopetrol holds a 55% operating stake and Repsol the remainder. The companies will submit an evaluation plan to the National Hydrocarbons Agency and undertake an extensive testing phase to determine the new field's potential.

Argentina's YPF inks deal with CGC to drill well in shale deposit – *Reuters*

YPF said it signed an agreement with Compania General de Combustibles (CGC) to drill the first exploratory well in the Palermo Aike shale formation, the second largest such deposit in the country. YPF is set to drill the Fraccion II - El Cerrito well in a concession belonging to CGC after both firms signed a memorandum of understanding (MOU), YPF said in a statement. The companies did not offer an investment figure or an estimated timeline for the well.

Palermo Aike, in the Patagonian province of Santa Cruz, is forecast to have shale oil reserves of some 10 billion barrels of oil equivalent. The deposit is considered the second most important shale play after Argentina's massive Vaca Muerta, the world's second largest shale gas reserve. In the statement, YPF chairman Pablo Gonzalez hailed the deal as historic, adding that it marks the first exploration push for hydrocarbons trapped in dense shale rock in Santa Cruz province. Argentina is looking to ramp up its oil production, which analysts believe will help reverse a longstanding energy deficit and allow the country to substitute pricy imports with local output.

Petrobras blocked from drilling at key offshore exploration zone – *Bloomberg*

Brazil's environmental authority has rejected Petrobras's request to drill its first well at an offshore oil frontier known as the Equatorial Margin, delivering a major setback to the state-controlled oil company's exploration plans. "There is no doubt that Petrobras was offered every opportunity to remedy critical points of its project, but it still presents worrying inconsistencies for safe operations in a new exploratory frontier of high social and environmental vulnerability," the regulator's president Rodrigo Agostinho said in the decision. Petrobras didn't immediately respond to a request for comment.

Ibama, as the agency is known, highlighted the extreme social and environmental sensitivity of the biologically diverse region that is home to indigenous lands, mangroves, coral reefs and endangered species. It has been a controversial location for drilling and has drawn concern from Brazil's environment minister, Marina Silva. Petrobras, has had an oil rig on site since early December waiting for approval to drill at the FZA-M-59 block, costing it about $1 million a day. The Equatorial Margin has similar geology as nearby Guyana, where Exxon Mobil Corp. has found billions of barrels.

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