September 15-30, 2023

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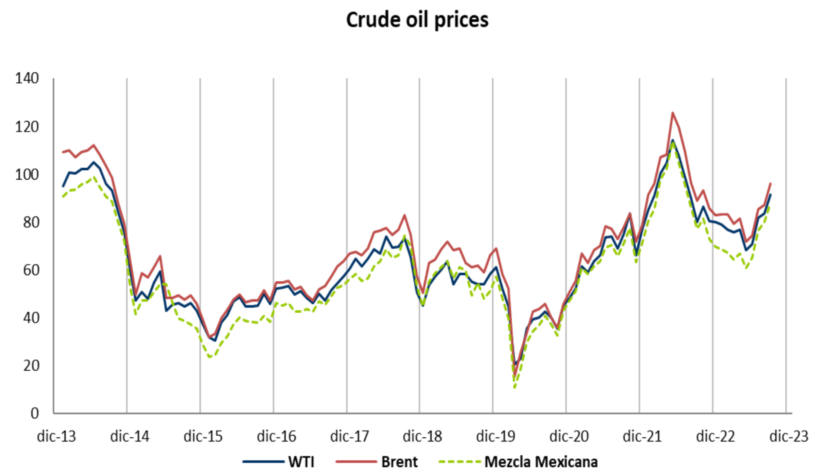
Fortnightly review

** 27/09/2023*

MME US/BD*	89.43
MME US/BD* PEF SHCP	68.70
Dif. MME AVG. 2023 vs. MME PEF SHCP	-8.95
NG price HH* US/MMBTU	2.76
Mx crude production MMbd – *July*	1.64
Mx NG production MMpcd – *July*	4,299
US crude production MMbd - *June*	12.84
FX Rate*	17.72



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

PEMEX: The Need for Reinvention - Luis Labardini Senior Partner at Marcos y Asociados

The long-standing petroleum culture of the oil monopoly in Mexico has always taken for granted that Pemex must not only explore and extract crude oil, but also refine it into petroleum products.

This is not necessarily the case. Exploration and production (E&P) and refining are two distinct and differentiated industries. The discovery and exploitation of hydrocarbons involves geosciences, soil and fluid mechanics, while refining is mostly about chemistry. In terms of the internal rate of return of investments, E&P is definitely a winner with an average return of around 37%, while refining has an average return of 8% when the business is properly managed. In terms of marketing, E&P is always subject to international oil prices, to volatility and shocks that respond to crisis and bottlenecks; while refining depends on the oil price, and is subject to extreme volatility, thin margins, seasonality and a complex geographic market environment.

Exploration and production generates the economic rent that derives from the exploitation of a natural non-renewable resource where, since the Napoleonic Code, the state holds an original right, compensated through the payment of royalties. Refining does not generate economic rent, and having a monopoly in refining is a challenge to say the least. It is mainly a challenge to the state-owned company, which must operate under the constraints of a national state and is expected to satisfy the total internal consumption of the country, even if it does not make financial sense.

In the case of Mexico, E&P has been a success story, providing for many years an economic rent that has contributed significantly to government finances, while reporting substantial net income results. This means that E&P has been good for the country, and also good for the long-term sustainability of Pemex, the state-owned company. On the other hand, refining has proven to be complex to manage in a monopolistic environment. Refining today is as challenged as it has ever been. Regarding the goal of providing competitive and sufficient fuels to the Mexican market, the Pemex refining arm has not been successful. The cost of producing a barrel of fuel in Mexican refineries is significantly higher than in international counterparts, while refineries are producing at 50% of their capacity. Mexico as a country has been increasingly importing fuels from abroad to satisfy the needs of the local market.

From a financial perspective, Pemex Refining (now known as TRI) has consistently been in the red, and it tripled its financial losses in 2020, 2021 and 2022. We must highlight that this is the Achilles' heel of the company, and the very reason the government of Mexico has had to financially support Pemex, aside from the historical debt that was not acquired by this administration.

Between 2018 and 2022, TRI's total net income has been negative, at MX$756.13 billion (US$45 billion); this is higher than the total capital contributions that the federal government has assigned to Pemex in the same period, which add up to MX$720 billion (US$43 billion). In other words, the financial losses of TRI have more than wiped out the great effort of the Mexican government to rescue Pemex.

Refining is a complex business, particularly in a monopolistic environment. Of particular concern is the very high level of fuel oil production, which is the case of Mexican refineries. This accounts for more than 30% of total production of fuels, while it's marginal in the rest of the world. Fuel oil used to be the main source of primary energy for the generation of electric power, but a profound conversion of Mexico's energy grid has drastically reduced the demand for fuel oil. Additionally, fuel oil is no longer accepted as a marine fuel.

Based only on the financial viability of Pemex in the long term, it is clear that refining operations are a burden for the company. Pemex must make a decision sooner than later, and it has two choices: shut down completely or sell the refining operations, therefore improving the financials of the company; or implement a comprehensive revamping program, that would require a very large investment. This investment would be provided by a strategic alliance with a seasoned refining operator with proven success in other parts of the world. It is unlikely and unadvisable for the government to embark on the type of investment that is required to revamp the National Refining System, if it wants to maintain healthy public finances.

Pemex is not only "too big to fail;" it also plays an important role in the Mexican economy, and it could transform itself into an efficient, competitive oil and gas company, not only providing economic rent, but also contributing to the cost-effective and timely supply of fuels required by the country's economy. Its demise could be much more costly, not only for the government, but also for the country as a whole.

Oil & Gas - Mexico

Talos Energy completes Mexico transaction with Grupo Carso – *Offshore Magazine*

Talos Energy Inc. and its Mexican subsidiary Talos Mexico has closed the sale of a 49.9% interest in Talos Mexico to Zamajal, SA de CV, a wholly owned subsidiary of Grupo Carso, controlled by Carlos Slim.

Talos received US$74.85 million in cash at closing, with an additional US$49.90 million due upon first production, for an aggregate price of $124.75 million. Talos Mexico, now owned 50.1% by Talos Energy and 49.9% by Carso, holds a 17.4% interest in the Zama Field. Talos will remain the controlling shareholder of Talos Mexico.

In June 2023, Mexico's CNH approved the Zama Unit Development Plan. Talos is working with the Zama Unit's Integrated Project Team to progress the front-end engineering and design and other workstreams required to reach a Final Investment Decision (FID). Talos will co-lead the planning, drilling, construction, and completion of all Zama wells and the planning, execution, and delivery of Zama's offshore infrastructure.

Talos President and CEO Timothy S. Duncan commented: "We are excited to partner with Carso on Zama, one of the largest global shallow water oil discoveries in recent years. We expect that Talos's strong operational track record combined with Carso's critical local presence and global commercial reputation will enable us to further advance Zama toward FID and first production."

Pemex will invest up to US$344 million in Chalabil allocation – *CNH*

CNH authorized the modification of the exploration plan presented by Pemex E&P, regarding the assignment AE-0157-M-Chalabil.

The Chalabil assignment has an approximate area of 810.58 km² and is located in shallow waters, off the coast of the state of Campeche. The objective of the modification to the plan is to continue with the evaluation of the oil potential and the possible incorporation of resources through exploratory activities considered in the approved plan, as well as new activities, highlighting the drilling of a prospective exploratory prospect Hayabil-1AEXP, during the first half of 2024 in the base scenario.

Hokchi Energy initiates dispute with Pemex over US $188 million debt – *Mexico News*

Pemex is struggling to pay firms that play a crucial role in allowing it to perform its core functions extracting and refining crude. Pemex has failed to pay at least three suppliers and contractors on time this year, one of which has opened a dispute resolution procedure against the state-owned firm, according to documents obtained by the Latinus news. Latinus obtained three letters that show that Pemex has outstanding debts to Hokchi Energy, Baker Hughes and Mexican rail operator Ferromex.

Pemex owes over US$500 million to those companies. Hokchi, the Mexican subsidiary of Argentine company Pan American Energy, notified the state oil company on Sept. 14 that it has initiated a dispute resolution procedure due to "lack of payment,". Hokchi, which supplies oil and gas to Pemex, says it is owed almost US$188 million plus interest and financial costs it has incurred.

Latinus also obtained a letter sent to Romero by Jesús Rosas, the general director of Baker Hughes de México. The Sept. 13 letter mentioned an "unusual delay" of payments to "different entities" of Baker Hughes. Rosas said the company was currently owed US $308 million, "which represents almost five months in delays in payments." In another letter sent to Ramírez last Monday, Romero noted that Ferromex had "suspended the service of removal of fuel oil" from Pemex refineries in Tula, Hidalgo, and Salamanca, Guanajuato, due to "lack of payment." Pemex's debt to Ferromex is about US$18.45 million.

The money owed to Hokchi, Baker Hughes and Ferromex is just a small fraction of Pemex's total debt obligations in the near term. The company had debt obligations of 746.7 billion pesos (US $43.44 billion) at the end of June. Of that amount, 231.15 billion pesos (US $13.45 billion) is owed to suppliers and contractors and 516.45 billion (US $30 billion) is classed as other debt.

Delay in clean fuel adoption sparks environmental concerns – *Mexico Business News*

The Citizen Air Quality Observatory expressed its concerns regarding the CRE's decision to once again grant Pemex an extension to comply with the Official Mexican Standard NOM-016-CRE-2016, which pertains to the quality of fuels.

The organization claims that the CRE's decision will delay the introduction of clean fuels by 14 years, hindering people's right to breathe clean air and have a healthy environment, while slowing down Mexico's advances in meeting its climate commitments. During a meeting of CRE's governing body on Sept. 14, 2023, the organization agreed to extend Pemex's deadline to meet the sulfur content requirement to Dec. 31, 2024. The NOM-016-CRE-2016 establishes that conventional automotive diesel can be used throughout the country, except in the metropolitan areas of Mexico City, Guadalajara and Monterrey, where ULSD was initially required until 2018. However, the authority has been granting extensions since then.

On July 1, 2018, the new NOM-016 established that from this date onward, the maximum sulfur content in this petroleum product would be 15ppm throughout the country. Subsequently, NOM-016-CRE-2016 postponed the deadline to 2020. "Pemex TRI filed legal actions to avoid complying with the resolution and the CRE granted a five-year extension. The most recent modification occurred on September 14 when, in an extraordinary session of the CRE's governing body, the commissioners unanimously approved a resolution extending the deadline for the production, distribution and sale of ULSD throughout the country to begin in 2025, five years after the initially planned date," explains the Mexican Center for Environmental Law.

It adds that due to Pemex's delay, the technological transition to higher emission control standards to reduce the impact on air quality and climate change has been delayed until 2025. The organization demanded that, to address this problem, Pemex should focus on strategically distributing imported ULSD and on developing labeling stations, pumps and vehicles to enable the implementation of the latest European emission standard, known as Euro VI, in Mexico.

Mexico's Pemex resumes trading with Vitol, three years after graft scandal – *Reuters*

Pemex has resumed dealing with Vitol, nearly three years since deals with the world's largest independent energy trader were banned over a graft scandal.

The ban followed Swiss-based Vitol's public acknowledgement in December 2020, in a deal with the U.S. Department of Justice, that it had paid kickbacks to win business with Pemex, as well as state companies in Brazil and Ecuador. In recent days, two vessels carrying Vitol cargos arrived at two Mexican ports. Neither the deals nor the fact that Mexico resumed trading with Vitol have previously been reported. Port records showed Arvin carried regular gasoline and methyl tert-butyl ether, or MTBE, an additive for unleaded gasoline that increases octane and oxygen levels and reduces pollution. Torm Thames carried premium gasoline and MTBE.

Reuters was unable to determine the terms of the settlement between Mexico, one of the world's largest importer of refined oil products, and Vitol. It was unclear when negotiations restarted. Meanwhile, legal proceedings in the U.S. continue. Javier Aguilar, a former manager for an affiliate of the Vitol group of companies, appeared in court on Aug. 21, pleaded not guilty and was released on a $100,000 bond.

Power/Renewable Energy – Mexico

CFE to invest US$750 million in electricity transmission network – *Mexico Business News*

CFE plans to make an investment of at least US$750 million to expand the National Transmission Network in the northwest, north and western regions of the country, according to Héctor Alonso Romero Gutiérrez, an expert in finance and energy markets.

Recently, CFE announced that it had invited companies involved in the electricity industry to present a mega transmission project, aiming to ensure a reliable energy supply. The project is called "Increase in Electric Energy Transmission on the West Coast of the Country," referred to as "I20" Phase 1 and 2. Due to its magnitude and significance for the National Electricity System, it is considered one of the most important and significant efforts to strengthen the transmission network.

The estimated cost of this project is based on a formula indicating that developing 1km of electrical transmission line costs approximately US$1 million. CFE's investment will not only cover network expansion but also the incorporation of equipment to ensure the network’s stability and quality, making the project a comprehensive initiative.

In the first phase, CFE plans to install four state-of-the-art dynamic reactive power devices known as STATCOM (Static Compensators), which improve key aspects such as voltage, frequency, power flow and stability in electrical transmission systems. These devices will play a fundamental role in providing regulation and damping in the event of potential network issues.

The second phase of the project involves the installation of 766km of 400kV transmission lines that will cross the states of Sonora, Sinaloa and Nayarit. Additionally, eight feeders and three reactor banks will be included. These improvements will enable a more reliable and uninterrupted integration of electrical energy produced by generation plants into the network.

To finance this project, CFE is considering various options, including the FIBRA E, a financial instrument that allows it to obtain resources for infrastructure projects. CFE has sought alliances with suppliers and chambers in the execution of this project, always under the direction of the state.

Mexico Infrastructure Partners will place a CKD for energy projects – *El Economista*

Mexico Infrastructure Partners (MIP), a fund created in August 2022 by Mexico Infrastructure Partners, will issue a Development Capital Certificate (CKD) with an initial amount of US$484 million that will be used to invest in electric energy projects.

The investment vehicle will be divided into three tranches, as outlined in the placement prospectus. The CKD will encompass a total amount of US$2.42 billion. These resources will be drawn upon as needed by the issuer, using the mechanism known as capital calls. "The trust may make direct or indirect investments related to the planning, design, construction, development, operation, and maintenance of electric energy projects" is stated in the placement prospectus.

MIP previously reached an agreement in April with Iberdrola to acquire 13 electric power generation plants for approximately $6 billion. These assets include 12 combined-cycle plants with a total installed capacity of 8,436 MW and one 103 MW wind farm. The funds raised by MIP through the CKD, from institutional investors like Afores, will be used to finance the acquisition of Iberdrola's electric power plants.

Recently, the Ministry of Finance reported that the project will be financed by 60% through debt issuance, and the remaining 40%, equivalent to 45,000 million pesos, will come from capital contributions from the National Infrastructure Fund and institutional investors. Another portion of the resources, amounting to 66,500 million pesos, will be provided by development banks such as Nafin, Banobras, and Bancomext, as well as institutional investors.

Oil & Gas - LATAM

DOF group bags US$260 million service contracts from Petrobras – *Rigzone*

Norway's DOF Group ASA has won three new service contracts with a combined value of over $260 million from Petrobras. The contracts, are targeted to start in the fourth quarter of 2023 and the first quarter of 2024. The contracts include work within the company's core service lines for survey and inspection. DOF hopes to execute more than 3,200 inspections within two years.

The DOF Group said the contracts represent a continuation of the services handled by the company under the PIDF123 contracts signed with Petrobras in 2020 and under operation since December of the same year. At least three vessels will be tapped to perform flexible pipeline, risers, and subsea equipment inspection in the Campos Basin, the Santos Basin, and the Espírito Santos Basin.

Petrobras recruits Chinese banks to finance deepwater oil expansion with world's largest FPSO fleet – *Bloomberg*

Petrobras recently held discussions with Chinese financial institutions to secure loans for its operations, as well as for its equipment and services suppliers, CFO Sergio Caetano Leite said. The idea is to make sure there's enough affordable capital available for deepwater oil projects in Brazil's South Atlantic.

Petrobras's outreach comes as President Luiz Inacio Lula da Silva pursues Chinese investment to deliver on his ambitious plans to reindustrialize Brazil's economy. China is Brazil's largest trading partner and buys nearly a third of all its exports. Many of the floating, production, storage and offloading (FPSO) vessels that Petrobras buys or leases are assembled at Chinese shipyards. This makes it easier for FPSO builders to get Chinese loans for the vessels, which can cost as much as $3.5 billion each. Chinese banks will also help Petrobras finance renewable energy projects.

Chinese financial institutions already account for more than 25% of Petrobras's loans, and Leite sees this share rising even though the company will keep total liabilities below $65 billion. Petrobras signed five-year term agreements with China Development Bank and the Bank of China during a business trip to the country last month.

Management met with other financial institutions including Sinosure, CITIC Bank, ICBC, and Chinese sovereign funds. Petrobras is studying opening a Chinese subsidiary next year to focus on finance and procurement.

Petrobras has the biggest and fastest-growing FPSO fleet on the planet. It will add 14 more by the end of 2027, and if its suppliers have better access to credit, it will lower overall costs, Leite said. Petrobras, is also working to get closer to Middle Eastern countries. After the trip to China last month, officials stopped in Abu Dhabi for meetings with companies including Adnoc and Mubadala Capital. The company also plans a visit to Saudi Arabia soon. Petrobras itself is planning to earmark up to 15% of its total investments toward renewable energy projects and is looking for partners to share investment costs.

This is a newsletter industry update courtesy of Marcos y Asociados Consultoría Energética, SAPI de CV.
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