Energy Fortnightly News

February 1-15, 2024

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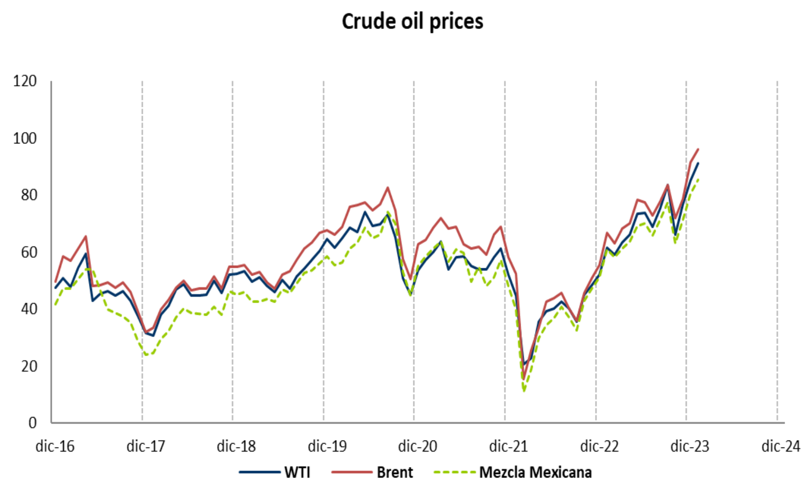
Fortnightly review

* 15/02/2024

MME US/BD*	72.07
MME US/BD* PEF SHCP	56.30
Dif. MME AVG. 2024 vs. MME PEF SHCP	13.00
NG price HH* US/MMBTU	1.58
Mx crude production MMbd – *December*	1.62
Mx NG production MMpcd – *December*	4,104
US crude production MMbd - *November*	13.30
FX Rate*	17.11



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

Oil & Gas - Mexico

Moody's downgrades Pemex's ratings to B3; negative outlook – *Moody's*

Moody's Investors Service downgraded Pemex Baseline Credit Assessment (BCA) to ca from caa3, which reflects its standalone credit strength. At the same time, Moody's downgraded Pemex's Corporate Family Rating (CFR), the backed senior unsecured ratings on the company's existing notes, as well as the backed senior unsecured ratings of Pemex Project Funding Master Trust, to B3 from B1. Moody's also downgraded both entities' backed senior unsecured MTN program to (P)B3 from (P)B1 respectively, and maintained the negative outlook for both issuers.

- Ratings rationale

The BCA downgrade to ca from caa3 reflects Pemex's increasing liquidity requirements due to expanding capital requirements, increasing cost of capital and significant upcoming maturities over the next 2-3 years. Further, the company faces increasing business risks as it continues to expand its refining capacity and attempts to grow production. The action also takes into account that Pemex's lack of measures to curtail its exposure to ESG risks has compelled some banks to limit their exposure to the company.

The downgrade to B3 incorporates Pemex's weakening stand-alone credit quality and reflects Moody's revised assumption of government support to High from Very High. Moody's foresees that any support from the next administration, although forthcoming in 2024-25, will likely come at a higher cost. The downgrade also incorporates the risk that the company could pursue a transaction such as debt exchanges, repurchases or other transactions that would reduce debt at a substantial discount to par or make other changes that Moody's would consider a distressed exchange, which is a default under Moody's definition.

Pemex's BCA of ca reflects Moody's expectation for negative free cash flow over the forthcoming three years. This trend is primarily attributed to significant debt maturities, peaking at $13.7 billion in 2026, and a decrease in operating cash flow stemming from the expansion of its loss-making refining business, which has accumulated operating losses of roughly $31.5 billion from 2019 to 2022, as reported. Despite the fact that oil and gas production growth has not met management targets, Moody's recognizes Pemex's achievement in reversing the downward trend in production and reserves over the previous three years. Moody's, however, notes that the 2024 budget suggests a reduction in capital investments compared to 2023, a shift that could potentially hinder future production and reserve replenishment.

Moody's anticipates Pemex will have to increase its reliance on external funding to counterbalance its negative free cash flow, influenced by multiple factors. These encompass the company's limited ability to improve its business performance due to the maturity of its oil fields; insufficient capital for adequate investment in exploration and production, potentially impacting production and reserve replacement; and the mandate to enlarge its refining business. Moody's expects that the refining sector will continue to register operational losses and remain vulnerable to medium-term trends in oil and gas demand. Governance risk is a consideration in the rating action. The company operates with aggressive financial policies reflected in weak liquidity and very high debt levels, resulting in a capital structure that is untenable.

Pemex has weak liquidity and is highly dependent on government support. On September 30, 2023, Pemex had $4 billion in cash to address over $10.9 billion in debt maturities in 2024, besides substantial negative free cash flow in the period, driven by insufficient operating cash generation to pay taxes and invest in capital. Moody's recognizes that the government's budget includes roughly $8.5 billion for debt maturities in 2024.

Pemex's B3 ratings take into consideration Moody's joint default analysis, which includes the rating agency's assumptions of high government support in case of need and very high default correlation between Pemex and the Government of Mexico (Baa2, stable), resulting in four notches of uplift from the company's ca BCA.

The negative outlook on Pemex's B3 ratings primarily reflects Moody's expectations that, barring a structural reform in its business strategy, Pemex's cash flow generation and credit metrics will further deteriorate over the next three years increasing the need of support. The negative outlook also acknowledges the potential for a distressed exchange over the several years as much of Pemex's debt trades at significant discount to par.

Mexico’s Pemex gets tax relief in presidential decree – *Bloomberg*

President AMLO published a decree that removed so-called DUC levies on Pemex for the four months through January. The ruling saves the company about 70 billion Mexican pesos ($4.1 billion), according to an official with knowledge of the matter who asked not to be named because they are not authorized to speak to the media.

The tax relief is the latest aid for Pemex provided by AMLO, who has made the revival of the company one of the central platforms of his government, which ends this year. Moody’s had cut the oil producer deeper into junk territory Friday, warning it could face a distressed debt exchange without continued government support. Pemex bonds held steady even after faster-than-expected US inflation damped bets on the pace of Federal Reserve interest rate cuts. The extra yield that investors demand to hold Pemex 2060 bonds over comparable sovereign bonds narrowed 17 basis points to 4.74%.

The fresh aid comes on top of unprecedented budgetary support for Pemex this year. The oil driller's debt has rallied since late 2023 when AMLO explicitly put 145 billion Mexican pesos ($8.5 billion) in the fiscal budget to help the company meet debt payments, after years of ad hoc capital injections and tax breaks to support the driller. The 2024 budget also further lowered the DUC. The government has not presented a longer-term plan for reducing the company's debt burden.

Woodside receives social impact assessment approval for Trion project – *Woodside Press Release*

Woodside announced that the Trion oil and gas project has received approval for its Social Impact Assessment from the Mexican Ministry for Energy. The Social Impact Assessment was submitted in May 2023. It provides a comprehensive assessment of the project and outlines the ways in which Woodside will manage social impacts. "This approval marks an important milestone on the pathway to developing this nationally significant resource project," said Woodside Executive Vice President Projects Matthew Ridolfi. "We appreciate the ongoing support we have received from the Mexican government for Trion. "The approval also validates Woodside's approach to how we engage with communities wherever we work and recognizes our high operating standards. It reflects the excellent work of our technical team, our consultants, and the strong professional relationships we have established with Mexico's regulatory authorities." Mr Ridolfi noted that the Social Impact Assessment will be a critical tool in helping manage the project during the construction phase.

Trion is a greenfield development that would represent the first oil production from Mexico's deepwater. It is located in the Gulf of Mexico at a water depth of 2,500m, approximately 180km off the Mexican coastline. Trion is being developed by Woodside Energy in a joint venture with Pemex. First oil is targeted for 2028.

Grupo Carso open to expand participation in Talos – *Business Mexico News*

Carlos Slim shared that Grupo Carso is willing to increase its involvement in Talos Energy. "It depends on the conditions. Slim emphasized his interest in both the Mexican subsidiary, where Grupo Carso owns 49.9% of the entity, and the parent company, where it holds around 18% ownership.

The decision to collaborate with Talos stems from Grupo Carso's desire to partner with an experienced player in the sector. "We are not entering to be 10% of Zama; we are looking to go further and have activity in the most important sector and eventually reach petrochemicals," added Slim. Slim's interest in the oil business aligns with Grupo Carso's diverse energy portfolio, which includes refining, petrochemicals, and other ventures. Slim has expanded his energy holdings through various family-run companies, from gas pipelines to oil fields. According to El Economista, Carso Energy, the energy division of Grupo Carso, constitutes 18% of the earnings of the Carlos Slim conglomerate, compared to 6% in 2018.

Last May, Zamajal, a subsidiary of Grupo Carso, finalized a deal to acquire a 49.9% stake in Talos Mexico, which holds a 17.4% participation in the Zama mega-field. The transaction, valued at US $124.7 million, was paid in two installments. Zamajal's investment was set to strengthen its position in the industry and expand its portfolio in oil businesses. In September Talos Energy completed the sale of the stake of its subsidiary, Talos Mexico, to Zamajal. Talos received US $74.8 million in cash upon closing the transaction and is set to receive an additional US $49.9 million upon the start of oil production, bringing the total price to US $124.7 million.

The Zama offshore field has been at the center of a significant conflict in the oil sector since its opening to private investment in 2013. A dispute arose between Pemex and the Talos-led consortium regarding ownership of the oil and gas reserves in Zama. The Ministry of Energy eventually ruled in favor of Pemex. In February 2024, however, CNH disclosed that Pemex faces delays at Zama, which will result in reduced oil production at the field.

Pemex platform in Mexico leaked methane despite UN Alert – *Reuters*

Recent data analysis unveils alarming methane emissions from a Pemex oil platform in the Gulf of Mexico, persisting even after a UN agency alerted the Mexican government to the issue. The analysis reveals significant methane leaks from the Zaap-C platform in 2022. Emissions continued for months afterward, indicating a persistent problem. Researchers initially attributed the leaks to a flare malfunction at the site.

The UN Environment Programme's International Methane Emissions Observatory program provided critical data, highlighting a series of methane plumes observed off the coast of Mexico. These plumes, identified on 25 different days in 2023, were traced back to the Zaap-C platform. UNEP notified the Mexican government about the initial nine plumes shortly after detection in July. However, subsequent detections did not prompt further notifications, raising questions about the government's response and communication with UNEP regarding the ongoing emissions issue. Data does not indicate whether Pemex has taken corrective action. The delayed release of UNEP data prevents real-time monitoring of the platform's current emissions status.

Wintershall Dea allocates major investment to Kan-1EXP discovery – *CNH*

CNH's approved the evaluation program and the initial work and budget plan for the years 2023 and 2024 to Wintershall. The contract operates under a shared production model and targets the evaluation and delineation of the discovered reservoir through the drilling of the Kan-1EXP Well. The program encompasses various activities, including 3D seismic reprocessing, geological studies, drilling of up to two delineation wells (Kan-2DEL), reservoir engineering, and other engineering tasks. Additionally, an incremental scenario includes drilling activities for the Kan-3DEL well.

The Kan well, drilled by the Borr Drilling's Ran platform, reached a total depth of 3,317m and encountered over 170m of net Upper Miocene sands with good petrophysical properties and high-quality oil. The budget allocation for the evaluation program stands at US $131.77 million in the base scenario and may reach US $237.39 million under the incremental scenario. A significant portion, approximately 85.5%, will be dedicated to drilling operations.

Diavaz will invest US $1,464 million in the development of the Miquetla field – *CNH*

CNH approved the modification to the development plan for extraction, presented by Operadora de Campos DWF (Grupo Diavaz), regarding the Contract CNH-M5-MIQUETLA/2018.

This is a contract for the extraction of hydrocarbons in the form of a license, coming from a Contract for the Exploration and Extraction of Hydrocarbons (CIEP). The contractual area is located 39 km northwest of the city of Poza Rica, Veracruz. Its producing field is located in the Chicontepec and Tamabra formation. Its fluid type is black oil and light oil, with a density of 28 to 38 degrees API.

The proposed modification to the development plan for extraction contemplates extracting a volume of 93.63 million barrels of oil and 234.54 billion cubic feet of gas at the economic, considering the recovery horizon of said volumes from February 2024 to November 2048, date of validity of the Contract. To this end, the contractor will carry out the drilling and completion of 350 wells and the execution of 116 major repairs, the construction of 406 pipelines, and two facilities. The total cost of the project is estimated at US $1,464.33 million, considering US $890.34 million for investment and US $573.99 million for operating expenses.

Pemex postpones plans for Zama field – *CNH*

Pemex encountered a significant setback in the development of the Zama field, impacting economic projections. Héctor Moreira, Commissioner, CNH, expressed concerns over the revised schedule, anticipating a loss of MX$30 billion (US $1.75 billion) in state revenue due to deferred activities.

Modifications to the development plan, approved by CNH, stemmed from delays in infrastructure tasks, with the initial production estimate reduced by 30%. Francisco Castellanos, Director General of Extraction Opinions, CNH, clarified that Zama's engineering phase precludes accurate annual production forecasts, highlighting the project's long-term nature. According to him, the rules for annual production forecasting cannot be applied because Zama is in the engineering and construction phase, but he acknowledged that the project, as presented by Pemex, "is delayed." Originally slated for 2024, production at Zama now faces a one-year delay, reflecting Pemex's adjustment of its budget from US $1.24 billion to US $70 million, a reduction of 94%. This drastic reduction, as per CNH, aligns with the revised timeline for infrastructure development. Through the modification, activities related to the construction of infrastructure in the 2024 work program are rescheduled, which includes platforms, pipelines, and separation batteries.

The approved development plan, requiring a total investment of US $9.08 billion, outlines a comprehensive strategy spanning 22 years, targeting the extraction of 625MMb of oil and 243Bcf of gas. The project envisages drilling 46 wells, constructing infrastructure, and implementing production processes to maximize hydrocarbon recovery. The Zama venture marks a pivotal milestone in Mexico's energy landscape, integrating public and private sector expertise to tap into substantial reserves. However, the recent adjustments underscore the challenges inherent in executing large-scale offshore projects, requiring meticulous planning and adaptability in navigating complex operational environments.

Power/Renewable Energy – Mexico

Mexican Supreme Court declares the 2021 Electric Power Reform as contrary to the Constitution – *Haynes Boone*

The Mexican Supreme Court (SCJN) declared as unconstitutional the provisions in the Reform to the Electricity Industry Law, which were proposed by the Federal Executive in 2021. This occurred on Jan. 31, 2024, and the principal effect of the Reform was to benefit the State Productive Entity, CFE, in the order of dispatch of power generated by it over private generators (including renewables).

The unconstitutionality of the Reform derived from several constitutional challenges (amparo) filed by private companies in the energy sector against the Reform, which were favorably resolved by a District Judge. In response to such resolution, appeals for their review were filed, which were attracted by the SCJN for their resolution.

With three votes in favor, the Second Chamber of the SCJN resolved that the Reform breaches the principles of free competition, since it seeks to prioritize the dispatch of CFE's power plants or the plants associated with them, which may generate an alteration in the electric power market by modifying free competition. Likewise, the SCJN resolved that in power generation, the CFE must be considered as another competitor in the market under equal circumstances.

Another relevant point included in the resolution of the SCJN was the acquisition of Clean Energy Certificates, which the Reform intended that not only market participants under the new regime (generators of clean energy) would acquire CEL's for the production of clean energy, but also the participants of the old regime (legacy regime), resulting in a disincentive for the production of clean energy.

Finally, the SCJN established that their decision regarding the Reform will apply generally over all participants of the Wholesale Electricity Market, including the CENACE as operator of the MEM and the National Electric System. In his conclusions, Justice Laynez determines that the economic leadership entrusted to the State has limits in the constitution itself, and the contested reform does not respect them. Furthermore, neither dispatch security nor the strengthening of CFE can outweigh energy efficiency.

The court's ruling addresses concerns raised by US Deputy Trade Representative Jayme White, who recently urged Mexico to rectify energy policies disadvantageous to US companies. The United States challenged the 2021 amendment favoring CFE over private competitors and pointed to Mexico's actions hindering private companies' operations in its energy sector. The SCJN's decision emphasizes the need for regulatory clarity to attract foreign investment and ensure fair competition.

In 2021, the government modified the LIE, changing articles related to dispatch priority, interconnection with the National Electricity System and CEL's, among other priorities. The proposed reforms gave state-owned power utility, CFE, an advantage over other private electricity companies, contend analysts.

Injunction requests from private companies soliciting protection from the amendments were originally submitted in 2022 but the SCJN dismissed them. At the beginning of the year, the SCJN announced it would revise the requested injunctions, seeking to settle issues like the preferential dispatch for CFE's energy, the elimination of auctions to contract of energy supply, and the modification of CEL's.

The injunctions aimed to modify LIE's third article and sections referring to power plants, electricity coverage contracts with a physical delivery commitment and legacy contracts for basic supply. Others cited specific complaints against Art. 53, related to electricity coverage contracts by auctions and Art. 108, referring to CENACE faculties.

Brazil's Petrobras seeks to settle refinery deal structure with Mubadala – *Reuters*

Petrobras opens new tab hopes to settle details of a tie-up with Mubadala to take back control of the operation of a refinery owned by the Abu Dhabi sovereign investor by the end of the first half of the year, Petrobras' chief executive said. CEO Jean Paul Prates said that both firms will intensify efforts on the corporate and operational details of the deal over the Landulpho Alves Mataripe Refinery (RLAM), in Brazil's northeastern state of Bahia.

The negotiations are part of a broader deal that would involve Petrobras partnering with Mubadala on biofuel projects. The refinery was sold under previous management to Mubadala in 2021 for $1.65 billion, as part of a divestment strategy enacted during the far-right administration of former President Jair Bolsonaro. Last year, after leftist Luiz Inacio Lula da Silva took office, Petrobras suggested it could buy back refining assets to boost its fuel production. When RLAM was sold it was taken out of Petrobras' network, losing synergies with other refineries and becoming less competitive, but the deal would bring RLAM back in, Prates told Reuters.

Petrobras has previously said in a securities filing that it would "evaluate the acquisition of a stake" in RLAM and Mubadala-owned Acelen Renewable Energy. RLAM accounts for about 10% of Brazil's oil refining capacity. In September, Petrobras signed a memorandum of understanding to study joining Mubadala in its downstream operations in Bahia, including a biorefinery in which the Abu Dhabi fund estimates $2.5 billion of investment would be needed. At the time, sources told Reuters that the partnership could open the door to talks on RLAM as Petrobras remained keen to repurchase the refinery, despite potential antitrust hurdles.

Barclays to adopt fresh curbs on oil and gas financing – *Reuters*

Barclays, Britain's biggest lender to the oil and gas industry, will stop direct financing of new oil and gas fields and restrict lending more broadly to energy companies expanding fossil fuel production.
The move, part of its Transition Finance Framework, follows intense pressure from campaigners over its energy policy amid an increase in climate damaging emissions from the burning of fossil fuels. In addition, from 2025, the bank will curb broader financing to non-diversified companies such as pure-play exploration companies if more than 10% of their expenditure goes toward expanding production over the longer term.

Barclays joins banks such as HSBC and BNP Paribas that are tightening oil and gas lending while pledging to increase funding to areas such as renewable energy that can help cap global warming, targeting $1 trillion in such lending by 2030. Non-profit ShareAction, that had pressured Barclays to do more to help tackle climate change, said that in response to the new curbs it had withdrawn a proposed shareholder resolution calling for the bank to stop funding new expansion projects.

The project finance curbs are not expected to have a major impact on its business given its limited market share. The bank was the biggest funder of fossil fuels in Europe between 2016 and 2022 and the second-biggest in 2022, a report by the non-profit Rainforest Action Network showed, opens new tab, though most of it came from corporate lending rather than project finance. Barlow said the bank's oil and gas on-balance sheet financing as a percentage of its total lending activities was less than 2%, with capital markets financing for the sector less than 3% of total activity.

Additional restrictions introduced by Barclays include no financing for exploration and production in the Amazon, and, from June 2024, no financing to firms that get more than 20% of their production from unconventional sources such as oil sands. All Barclays corporate clients in the energy sector will be expected to present transition plans or decarbonisation strategies by January 2025, alongside 2030 methane reduction targets, and a commitment to end all non-essential venting and flaring by 2030. The clients would also need to have near-term net-zero aligned targets for Scope 1 and 2 emissions - those linked to their own operations and energy usage - by January 2026.

Ecopetrol embarks on US $250 million refinery works – *Bnamericas*

Ecopetrol has outlined plans to invest 1tn pesos (US$254mn) this year to carry out maintenance work at its Barrancabermeja refinery. Works include the reconditioning and upgrading of plants, tanks, boilers and turbo generators, the company said. It added that around 1,500 jobs would be created between February and August.

The maintenance program anticipates "30 interruptions or stoppages", according to Ecopetrol, which said there were 29 such events in 2023. In 2022, the national oil company announced that it would invest 3.2tn pesos by 2025 to modernize and expand the refinery. It said the funds would be used for circular water management, fuel quality improvement, renewable energy, green and blue hydrogen development, carbon capture, and utilization and storage, among other initiatives.

Located in the northern department of Santander, the Barrancabermeja complex is Colombia's largest oil refinery, processing an average of 225,000b/d of crude from 54 distillation units.

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