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## Research Update:

# Petróleos Mexicanos (PEMEX) 'BBB' Ratings Affirmed, Outlook Remains Stable

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## Research Update:

# Petróleos Mexicanos (PEMEX) 'BBB' Ratings Affirmed, Outlook Remains Stable

## Overview

- Operating and financial performance of Mexico-based oil company PEMEX continues to be in line with our expectations.
- We are affirming our 'BBB' foreign currency, 'A-' local currency, and 'mxAAA/mxA-1+' national scale ratings on PEMEX.
- The stable outlook reflects our expectation that PEMEX's relationship with the government won't significantly change in the next two to three years.

## Rating Action

On Aug. 7, 2012, Standard & Poor's Ratings Services affirmed its 'BBB' foreign currency, 'A-' local currency, and 'mxAAA/mxA-1+' national scale ratings on Petroleos Mexicanos (PEMEX; please see ratings list below). The outlook remained stable. This affirmation follows our regular annual review.

## Rationale

The ratings on PEMEX reflect our opinion that there is an "almost certain" likelihood that the Mexican government would provide timely and sufficient extraordinary support to PEMEX in the event of financial distress. The foreign-currency credit rating on PEMEX is one notch above the company's stand-alone credit profile.

In accordance with our criteria for government-related entities, our view of an almost certain likelihood of extraordinary government support is based on the following assessments:

- PEMEX's "critical" role as the only exploration and production (E&P) company operating in Mexico;
- Its provision of about 40% of Mexico's public-sector revenues through taxes and duties; and
- "Integral" link with the government, given the government's full and stable ownership of the company and the fact that the government determines its key budgetary decisions.

The ratings on PEMEX also reflect Mexico's large oil and gas reserve base, PEMEX's monopoly status in the large national oil and gas market, and its central role in Mexico's energy sector. PEMEX's significant financial risk profile (according to our criteria), its weak after-tax measures, and aggressive capital expenditures program are negative credit factors. The

company's after-tax financial measures reflect the weight of its large unfunded pension obligations and a substantial share of revenues taken by the government, which result in funds from operations (FFO) to debt of less than 10%. This has resulted in PEMEX financing about 40% of its capital expenditures with debt during the past several years.

PEMEX awarded the second round of contracts for mature fields in the North Region. A total of six blocks were tendered, of which only four were assigned: Altamira field to Cheiron Holdings Ltd. (part of Pico International Petroleum), Panuco field to Dowell Schlumberger de Mexico and Petrofac de Mexico, and Tierra Blanca and San Andres to Monclova Pirineos Gas in consortium with Alfasid del Norte. These fields hold 3P reserves of 98 million barrels of oil equivalent (MMboe). The production is expected to reach 70 million barrels per day (mbpd). The remaining two blocks (off-shore blocks Atun and Arenque) will be tendered in September. We expect that Chicontepec and Deepwater fields will be tendered in early 2013. In our opinion, these contracts could increase company's production and the recovery factor in the fields.

The company has been able to stabilize crude oil production at about 2.5-2.6 mbpd. During the second quarter of 2012, company's total crude oil production was 2.540 mbpd and 5,675 million cubic feet per day of natural gas, reaching a production of 3.689 MMboe per day. Although there are some improvements in its Cantarell asset, such as the 64% increase in production at the Sihil field during the 12 months ended June 2012, the overall production from this asset continues to decline at a 0.86% rate in 2011. We expect that the increased output in Ku-Mallob-Zaap, Crudo Ligerito Marino, Ixtal-Manik, and Delta Grijalva fields and the company's capital expenditures at the E&P segment will continue to offset this decline.

For the 12 months ended June 30, 2012, PEMEX's FFO to total debt, EBITDA interest coverage, and total debt to EBITDA were 8.3%, 9.3x, and 1.8x, respectively. (These ratios incorporate as debt-like obligations the company's unfunded pension liabilities and asset retirement obligations of about \$66.3 billion). We expect that taxes will remain a significant burden on the company's finances. Therefore, we expect after-tax financial performance to be weak for the rating. Based on our price deck for oil and gas (see "Standard & Poor's Raises Its U. S. Natural Gas Price Assumptions; Oil Price Assumptions Are Unchanged," July 24, 2012) and adjusted for domestic factors, we expect that PEMEX would likely post total adjusted debt to EBITDA and FFO to total debt in the 2.0x-2.5x and 10%-15% ranges in the next two years.

## **Liquidity**

We assess the company's liquidity as "adequate" under our criteria. Our liquidity assessment is based on the following assumptions:

- We expect PEMEX's liquidity resources (including cash, FFO, and credit facility availability) to exceed uses by 1.2x during the next 12-18 months;
- We believe that the company's resources can more than cover its needs for

the foreseeable future, even if EBITDA declines 20%; and

- The company's easy access, with ample track-record, to bank financing as well as to domestic and international capital markets also supports its adequate liquidity. For instance, it has \$3.25 billion in credit lines available and its recent debt issuance is guaranteed by the U.S. Export-Import Bank and the bilateral credit line from Export Development Canada.

As of June 30, 2012, PEMEX has raised about \$6 billion in debt on international markets. We believe that PEMEX will continue to require external financing to support its investment program of about \$23.2 billion for 2012, which is mainly focused on E&P. The company does not have any financial covenants.

## Outlook

The stable outlook on PEMEX reflects our outlook on Mexico and our expectation that PEMEX's relationship with the government won't change significantly in the next two to three years. It also reflects our belief that the government won't significantly reduce its heavy involvement in the sector or in the company. Given our assessment of an almost certain likelihood of support from the government, upward or downward rating movements would most likely follow the sovereign's rating trajectory.

## Related Criteria And Research

- Standard & Poor's Raises Its U. S. Natural Gas Price Assumptions; Oil Price Assumptions Are Unchanged, Jul 24, 2012
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Sept. 28, 2011
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010
- 2008 Corporate Criteria: Analytical Methodology, April 15, 2008

## Ratings List

Ratings Affirmed

Petroleos Mexicanos

Corporate Credit Rating

Foreign Currency

BBB/Stable/--

Local Currency

A-/Stable/--

Caval - Mexican Rating Scale

mxAAA/Stable/mxA-1+

Senior Unsecured

BBB

Senior Unsecured

mxAAA

*Research Update: Petróleos Mexicanos (PEMEX) 'BBB' Ratings Affirmed, Outlook Remains Stable*

Senior Unsecured  
Commercial Paper

A-  
mxA-1+

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