SHCP

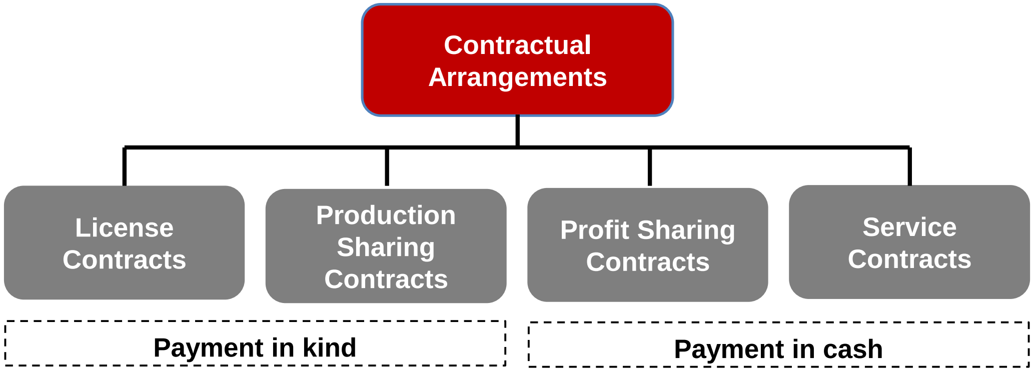
SECRETARÍA DE HACIENDA
Y CRÉDITO PÚBLICO

Economic Terms applicable for Exploration and Production Contracts

July 2017

E&P Contracts

- The Mexican Government has flexibility towards choosing the right fiscal system that allows companies to participate in a competitive environment.



- Mexican fiscal regime aligns with industry best practices and grants long-run certainty:
    1. Most of the fiscal elements are established by law, including: basic royalties, surface rents, and Corporate Income Tax (CIT).
    2. Overall, the fiscal regime is progressive.
    3. The contract states clear and simple rules for payment as well as stability mechanisms in case of changes in taxes, duties and rights applicable specifically to the E&P industry in Mexico.
- Cárdenas – Mora & Ogarrio are License Contracts
- Ayín – Batsil is a Production Sharing Contract

Fiscal Terms

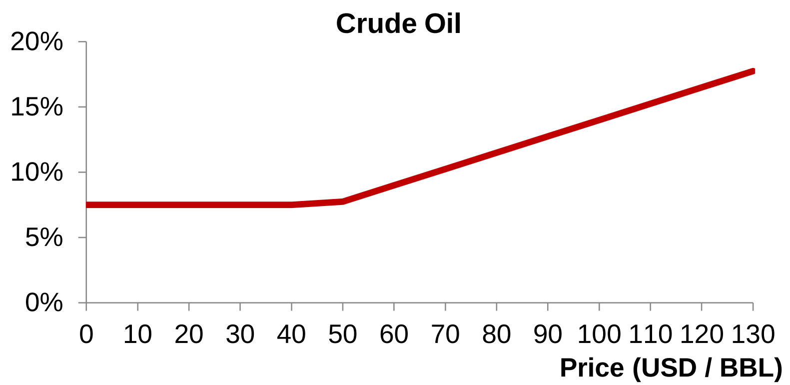
Defined by Law	
Corporate Income Tax (CIT)	• 30% of taxable income • Consolidation is possible amongst E&P projects
Value Added Tax (VAT)	• 16% (0% on exports) • Accelerated VAT recovery during pre-operating phases
Exploration and Extraction Activity Tax	• Exploration phase: 1,580 pesos/month (85 US$) per km^2 • Production phase: 6,330 pesos/month (342 US$) per km^2
Basic Royalty	• Variable formula depending on hydrocarbon type and price
Exploration phase surface rentals	• First 60 months: 1,210 pesos/month (66 US$) per km^2 • Month 61 & over: 2,900 pesos/month (157 US$) per km^2
CIT Depreciation rates	• Exploration — 100% • Development and production infrastructure — 25% • Storage and transportation infrastructure. — 10%

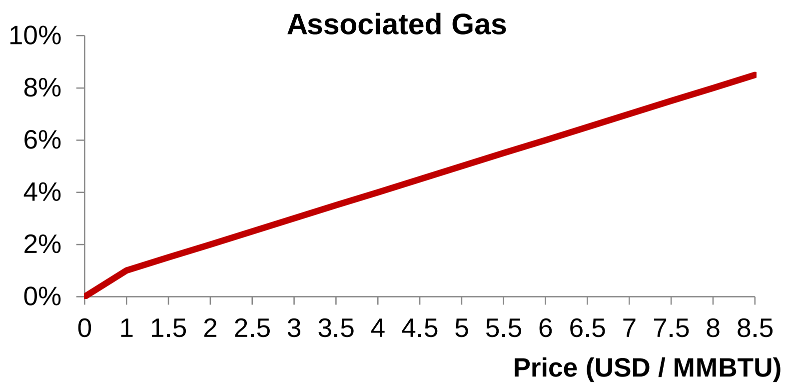
Defined by the Bidding process	
Contract Payments	• Additional Royalty (Cárdenas-Mora & Ogarrio Contracts) • Profit Share (Ayín-Batsil Contract)

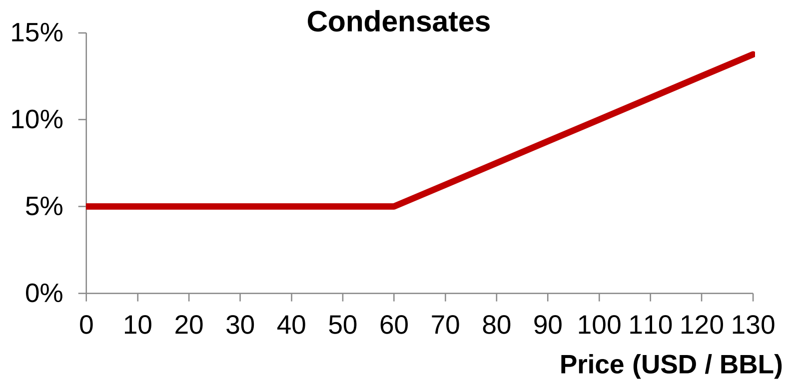
Defined in the Contract	
Adjustment Mechanism	Cárdenas-Mora & Ogarrio Contracts • In case of extaordinary levels of production Ayín-Batsil Contract • In case of extaordinary profits (Production Sharing Contract)

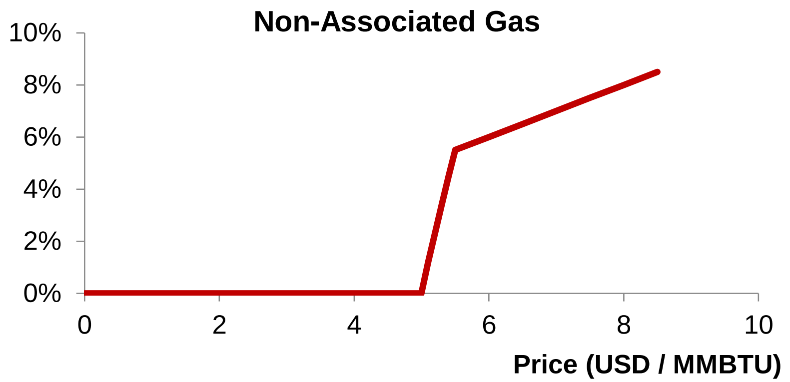
Basic Royalties

- Basic royalties as set in the Hydrocarbons Income Law are at competitive standard levels.









Cárdenas- Mora & Ogarrio

Item		Value
Adjustment mechanism	Oil and condensates	Volumetric sliding scale to capture extraordinary production
	Natural Gas	

Ayín-Batsil

Item	Value
Cost recovery limit	60%
Initial cost recovery stock	Investment already incurred by Pemex (250 mmUSD)
Adjustment mechanism	Profitability sliding scale to capture windfall profits

Cárdenas – Mora & Ogarrio	
Tender Mechanism	• Sealed – bid, first – price auction
Bidding Variable	• **Additional Royalty**
Allowed Values	• Min: 1.0% • Max: 13.0%

Ayín – Batsil	
Tender Mechanism	• Sealed – bid, first – price auction
Bidding Variable	• **Government´s profit share**
Allowed Values	• Min: 18.2% • Max: 25.0%

Tie-breaker mechanism

- Every bid proposal shall include a payment in cash offer to be opened in case of a tie, or if the bidder proposes the maximum value.
- The cash tie-breaker will be distributed and paid according to the following:

	Tie breaker amount	For PEMEX	For the Mexican State
Cárdenas-Mora	For offers under 69 mmUSD	100%	0%
	For offers over 69 mmUSD	69 mmUSD + 80% of the amount over 69 mmUSD	20% of the amount over 69 mmUSD
Ogarrio	For offers under 59.6 mmUSD	100%	0%
	For offers over 59.6 mmUSD	59.6 mmUSD + 80% of the amount over 59.6 mmUSD	20% of the amount over 59.6 mmUSD
Ayín-Batsil	Any amount	80%	20%

- Payments to the State become a signing bonus, payable to the Mexican Oil Fund.
- Payments to PEMEX become either: a signing bonus paid according to JOA terms (Licenses), or additional carry (PSC).

Other Fiscal Elements

▪ Payment and lifting	– Contractors lift their production (total volume in licenses or share of the total in PSCs).
▪ Reporting	– Revenue and costs shall be reported to the government for verification and transparency purposes via the electronic system of the Mexican Petroleum Fund:  – Cost reporting shall follow the accounting guidelines established by the Finance Ministry. – Cost classification will follow the same standard in terms of CIT determination.
▪ Procurement principles	– Flexible procurement methods with amount thresholds to reduce administrative burden. – All transactions with related parties shall be done at arm's length and operations must comply with OECD's transfer price principles.

Annex

Cárdenas- Mora & Ogarrio

Item		Value
Adjustment mechanism	Oil and condensates	Volumetric sliding scale starting on 30,000 barrels per day Top adjustment: Plus 20% additional royalty minus basic royalty
	Natural Gas	Volumetric sliding scale starting on 80 million cubic feet per day Top adjustment: Plus 10% additional royalty minus basic royalty

Ayín-Batsil

Item	Value
Cost recovery limit	60%
Initial cost recovery stock	Investment already incurred by Pemex (250 mmUSD)
Adjustment mechanism	Profitability sliding scale, measured through pre-tax IRR, starting after 25% IRR Top adjustment, at 40% IRR, adjusts contractor’s profit to: 25% of their share determined in the bid