Summary Rating Rationale

PEMEX’s Baa3/Aa3.mx/MX-1 ratings reflect Moody’s joint-default analysis, which includes our assumptions that there is i) a very high likelihood of extraordinary support from the government of Mexico (A3 negative) to avoid default, and ii) a very high default correlation between PEMEX and the government. The Baa3 rating incorporates six notches of uplift from PEMEX’s b3 baseline credit assessment (BCA). Our view on the likelihood of support considers the prominent role of PEMEX in the Mexican economy, its 100% government ownership, and recent verbal statements of government support for the company. We believe that it is important to the government to facilitate PEMEX’s continued access to the capital markets given the company’s role in generating hard foreign currency through oil exports and in paying large annual amounts in duties and royalties, which currently represent about 12% of the government’s annual budget. We believe that government support might come in a variety of ways, including additional supportive statements to inspire investor confidence for market access, temporary tax relief, and cash transfers, which have occurred in the past in the form of subscription to participation certificates.

PEMEX’s ratings consider the company’s sizable proved hydrocarbon reserves, which in 2014 amounted to 12,380 million boe, equivalent to 9.6 years of life; oil production averaging 2,267 mbd in 2015; a dominant role and integrated operations in the energy industry in Mexico; and its position as a major crude oil exporter to the US. However, the company’s standalone credit assessment and its ratings are increasingly affected by a heavy tax burden, weak cash flow, and high financial leverage. PEMEX’s ratings also consider challenges related to production, which has been falling in the last several years due to the natural decline of certain fields and a lower quality of crude oil as well as the company’s limited ability to invest efficiently.

Credit Strengths

» Robust size of reserves and production

» Energy law that benefits the company in the medium term, although also accompanied with execution risk

» Government related issuer with very high implied government support
Credit Challenges

» Tight liquidity
» High fiscal debt burden
» Weak credit metrics with negative trajectory

Exhibit 1
Historical Crude Oil Production, Proved Reserves and Leverage

Rating Outlook
The negative outlook for PEMEX’s ratings reflects our expectation that the company’s credit profile may deteriorate more substantially than the degree of weakening that is incorporated in the b3 BCA. However, we could revise the outlook to stable if the company manages to reverse the current trend of increasing leverage and shows indications that it can improve its operating and financial profile.

Factors that Could Lead to an Upgrade
An upgrade of PEMEX’s ratings is unlikely over the near term as is indicated by the negative outlook. For an upgrade to be considered, the company would need to significantly reduce its leverage and improve its operating profile, cash flow and liquidity. Simultaneously, we would have to maintain our current expectations for sovereign support. Improving operating metrics and a lower tax burden that supports higher levels of internal funding for capital spending and prospects for a solid trend of increases in production and reserves could benefit the company’s baseline credit assessment.

Factors that Could Lead to a Downgrade
A further material increase in financial leverage beyond current expectations, significant deterioration in production, or liquidity concerns could result in a downgrade of PEMEX’s BCA and debt ratings. In addition, because PEMEX’s ratings benefit from implicit support from the government of Mexico, a downgrade of the government’s rating or a change in Moody’s assumptions about government support could lead to a downgrade of PEMEX’s ratings.

2015 figures are unaudited. Data for proved reserves was not available at the time of publication of this report.

Source: Petroleos Mexicanos
**Key Indicators**

**Exhibit 2**

**KEY INDICATORS [1]**

<table>
<thead>
<tr>
<th>Petroleos Mexicanos</th>
</tr>
</thead>
<tbody>
<tr>
<td>--------------------</td>
</tr>
<tr>
<td>Average Daily Production (Mboe/d)</td>
</tr>
<tr>
<td>Proven Reserves (Million boe)</td>
</tr>
<tr>
<td>Total Crude Distillation Capacity</td>
</tr>
<tr>
<td>EBIT/Average Book Capitalization</td>
</tr>
<tr>
<td>Downstream EBIT/Total Throughput</td>
</tr>
<tr>
<td>EBIT / Interest Expense</td>
</tr>
<tr>
<td>Retained Cash Flow/Net Debt</td>
</tr>
<tr>
<td>Total Debt/Capital</td>
</tr>
</tbody>
</table>


**Detailed Rating Considerations**

**HIGH FISCAL BURDEN AND ELEVATED FINANCIAL LEVERAGE**

In the last three years, PEMEX’s leverage has increased to fund large outflows for taxes, duties and capital spending, without achieving sustained increases in production or operating efficiencies. In addition, since the sharp decline in oil prices that began in late 2014, PEMEX’s operating expenses have been resilient, with negative effect on credit metrics.

PEMEX’s pre-tax cash flow is abundant and could support high levels of investment, but capital retention and investment have been stymied by its heavy tax burden. The company has the lowest production costs in Latin America, of roughly USD 8/bbl; however, its tax burden was roughly USD 57/bbl over the last 12 months. PEMEX has traditionally paid out all of its EBITDA in the form of taxes, leaving it with the need to incrementally raise debt to finance fixed charges and capital expenditures.

Tax transfers to the government from PEMEX declined materially in 2015 from 2014 and will remain low in 2016, based on Moody’s oil prices assumptions. However, we believe that PEMEX will continue to provide most of its operating cash to fund well-above 20% of the government’s annual budget in the next 4 to 5 years. In the longer term, as the share of new oil exploration and productions projects increase in the company’s portfolio of projects, PEMEX’s tax burden should gradually decline, based on the new tax regime for the oil industry, as established in the new energy law. When this happens, we would re-assess our assumptions for support and dependence under the our joint-default analysis.

We recognize that in November 2015 PEMEX was able to negotiate a major change in its labor pension benefit plan, whose liability in December 2014 amounted to close to USD 100 billion. This change would improve PEMEX’s capital structure starting in 2016, as estimated by the company. As a consequence of the deal, the government should grant a similar amount to PEMEX in the form of short-term non-negotiable government bonds. As a matter of fact, in December 2015, the government transferred the first MXN 50 billion in non-negotiable bonds to the company related to the pension liability savings. However, these bonds do not immediately strengthen the company’s liquidity position but will serve to reduce the pension liability going forward.

**STABLE RESERVES BUT MILD PRODUCTION GROWTH PROSPECTS**

Despite its massive proved hydrocarbon reserves and resources, PEMEX is burdened by high taxation and a legacy of under-investment that has hurt reserves and production growth.

Crude oil production has gradually declined over the past years, averaging roughly 2.27 million bpd in 2015, a fall of 6% when compared to the previous year. Going forward, we estimate that production will decline 5% on average as a consequence of many factors, including limited ability to invest in exploration and production given lower cash generation derived from lower oil prices.
but also high duties and taxes. The pressure on PEMEX to increase capital expenditures to boost production could decline in 2016
and probably in 2017 as well, if the process to farmout existing production contracts accelerates and the company’s partners take a
significant share of investments in the oil fields instead of PEMEX. The company may also choose to sell some non-strategic assets or
use Fibra E (MLP-type of financial instruments) to raise capital to fund capital expenditures. However, these funding alternatives could
prove hard to execute under a relatively new energy law and overall adverse conditions in energy industry.

The deep water Gulf of Mexico and unconventional shale resources provide the greatest prospects for long-term reserves and
production growth in Mexico, but they also present major capital, development and technology challenges. While PEMEX was planning
to increase its deep water exploration spending and has had several significant oil and gas discoveries, much of its future success will
hinge on the new energy law and its impact on attracting third parties’ investment to the energy sector. We expect PEMEX’s core
Southeastern Basin to remain its most important producing area for the foreseeable future.

CAPITAL SPENDING ON INCREASING TREND IN THE MEDIUM TO LONG TERM

PEMEX’s legacy of underinvestment was changed during 2012-14, when there was a significant step up in capital spending and
government approvals of increasing budgets. However, given lower cash flows derived from lower oil prices, the company’s expenditure
was reduced to USD 14 billion in 2015 and we expect USD 12.5 billion in 2016, down from USD 15.1 billion in 2014.

The largest portion of capital expenditures will be directed to upstream, mostly in the Southeastern basins where Cantarell and
KMZ are located. Downstream investment is driven by the mismatch between PEMEX’s lighter refining capacity and an increasingly
heavy crude barrel, and by a need to reduce dependence on product imports. Due to the aforementioned recent reduction in capital
expenditures since 2015, final allocation of investments into downstream have been and will continue to be limited to maintenance
only.

Going forward, PEMEX should have more autonomy and further de-link it from the annual state budget process, but the extent to
which fiscal reform will leave more capital available to PEMEX remains unclear.

EVOLVING CORPORATE GOVERNANCE AND RELATIONSHIP WITH THE GOVERNMENT

Since October 2014 and as a result of the energy law reform, passed by Congress in late 2013, PEMEX is a productive state-owned
company, with more autonomy with regards to investment allocation. Also, the company’s board is now 50% independent. However,
the government continues to exert outright influence on the company’s decisions. For instance, PEMEX’s net financial balance as well
as its maximum borrowing threshold must follow the government’s guidance and are approved by Congress on an annual basis. In
turn, government support to PEMEX is exemplified by the MXN 20 billion and MXN 10 billion injected as cash equity contribution in
2014 and so far in 2015, respectively. The government is free to transfer cash to PEMEX at any time provided that it generates income
surplus.

However, PEMEX’s corporate governance should improve as its board composition was enhanced by a higher participation of
independent, experienced members of the business community. We expect transparency and effectiveness to increase going forward.
As a productive state-owned company, PEMEX’ Chief Executive Officer is appointed by the President of Mexico and its Board of
Directors consists of five representatives of the Mexican Government, including the Secretary of Energy (who serves as Chairperson of
the Board), and five independent members.

PEMEX’s has an Audit Committee, Human Resources and Compensation Committee, a Strategy and Investment Committee, and an
Acquisitions, Leasing, Public Works and Services Committee.

BENEFITS FROM THE ENERGY LAW BUT WITH EXECUTION RISK

During 2014, Mexico completed a major energy reform that will help transform PEMEX as well as the energy sector over time.
The most important change under the new law is the end of PEMEX’s monopoly, to its current status as “productive state-owned
enterprise”. The new law also 1) triggered changes in the company’s board of directors, which became more independent, 2) established
a range of contract structures to attract private investment in the entire O&G value chain, and 3) opened up PEMEX to a more
standard corporate and tax structure. The new upstream contract structures will have provisions to allow private companies to book
reserves (even though they remain assets of the state), removing a major impediment to earlier attempts to spur private investment in oil development in Mexico.

The new law will broaden the range of models for investment in Mexico, from the pre-existing service contracts to profit sharing contracts, production sharing contracts and licenses. Production sharing or other licensing arrangements between the state and private oil companies, where the companies can be paid in cash and oil, are likely to be more attractive to international oil companies, particularly in higher risk areas such as the deep water Gulf, unconventional shale, or even the complex Chicontepec field. In some cases PEMEX could enter into the contracts and bid jointly with private partners. The new structures will be a key step in attracting major oil companies and their technology.

It is positive for PEMEX that the company will be able to participate in joint-ventures with third parties that will provide additional access to technologies used in exploration and production of a wide variety of fields, such as deep water, shale, and mature fields, among others, which should improve the company’s business prospects in the long term. Moreover, the possibility of collaboration with third parties in downstream and midstream activities could generate economic benefits to PEMEX.

During so-called round zero, occurred in the second half of 2014, PEMEX obtained 100% of its request for 2P and 68% of its request of prospective resources. In the next few quarters, the company will migrate some of its current exploration and production service contracts into exploration and extraction contracts. In addition, selected fields assigned to PEMEX in round zero will be farmed out. Going forward, PEMEX will look for alliances with partners that have capital and operational expertise, are strategic suppliers of materials and can enter into Joint Ventures in its entire value chain, including cogeneration and transportation. These changes and opportunities promise value creation but raise execution risk.

On September 30, 2015, the government of Mexico held a successful second phase of its first-round auction of oil assets, attracting bids for three of five open blocks. We believe Mexico will attract USD 3 billion in investment from the second phase of the auction—a better result than the first phase in July 2015—, a critical step in Mexico’s effort to open its oil production to foreign companies for the first time since 1938. The third auction, held in December 2015, was also successful and all 25 fields of mature, onshore basins were awarded. The success of further bidding in 2016 for offshore properties will depend on bigger global private oil companies’ appetite for investments under a low oil price environment.

**Liquidity Analysis**
PEMEX’s liquidity is tight. Management’s goal is to hold at least USD 4.5 billion in cash at all times. However, as of December 2015, debt maturing in 2016 amounted to USD 11.7 billion. In addition, during the year, we expect the company to spend about USD 4.5 billion for interest and USD 12.5 billion for capital expenditures. PEMEX has recently demonstrated repeated access to domestic and international markets, raising funds in Mexican pesos, US dollars, Australian dollars, Euros, Japanese yen, and British pounds. So far in 2016, the company has tapped both global and local capital markets as well as certain banking credit lines and raised the equivalent of over USD 9 billion during the first quarter, after the government expressed verbal support at the beginning of the year. The company may also choose to sell non-strategic assets or use Fibra E (Mexican MLP-type of financial instruments) to raise funds to reduce debt financing needs. However, Moody’s believes that some funding alternatives will continue to be difficult to execute due to the relatively short experience under the new energy law.

**Profile**
Founded in 1938, PEMEX is Mexico’s productive state-owned oil company. Its monopoly status will change with the continued implementation of the new energy law, although, in the foreseeable future, the company will remain the dominant energy player in the country, with fully integrated operations in oil and gas exploration and production, refining, distribution and retail marketing, and petrochemicals. PEMEX is also a leading crude oil exporter, with approximately 50% of its crude exported to various countries, mainly the US. As of December 2015, PEMEX posted USD 67.8 billion in last twelve month revenues and its tax payments amounted to about 20% of the government’s annual budget. As of December 2015, its total assets amounted to USD 114.3 billion.

**Rating Methodology and Scorecard Factors**
The integrated oil methodology yields an indicated rating of B1 as of December 31, 2015, versus PEMEX’s BCA of b3. The methodology outcome reflects its large-scale operations, but also high financial leverage and the negative impact of the government’s fiscal reliance and influence on PEMEX.
## Ratings

### Exhibit 3

<table>
<thead>
<tr>
<th>Category</th>
<th>Moody's Rating</th>
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Source: Moody's Investors Service
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