On 21 March 2014, Petróleos Mexicanos (PEMEX, Baa1 review for upgrade) sent the Mexican government the selection of exploratory areas and production fields that it wants to keep and develop once the country opens the state oil industry to foreign investment for the first time since 1938.

PEMEX's ability to choose its preferred oil and gas assets is credit positive, giving Mexico's national oil company a significant competitive advantage over newcomers and guaranteeing its status as Mexico's dominant oil company for years to come.

In the medium-to-long term, we expect that PEMEX's tax obligations to the government will gradually decline, releasing financial resources for the company to invest mostly in profitable production, but also in refining and other energy projects.

PEMEX sent to the Ministry of Energy its list as part of "Round Zero," the first step in Mexico's unprecedented energy reform effort. Round Zero marks the first step in the energy reform to help convert PEMEX from a national oil company, and a government policy and funding vehicle, into what the government calls a "state productive enterprise." This reform aims to give PEMEX management and budgetary autonomy, which will help it compete with other oil companies. The government expects that this process to take about two years.

Mexico has more than 10 billion barrels of oil equivalent of proved reserves--Latin America's third-largest holding after Venezuela and Brazil. The energy reform, which Mexico approved in December 2013 after seven decades of monopoly power in Mexico's oil sector, allows for private investment for exploration and extraction of hydrocarbons under federal contracts to be overseen by the Comisión Nacional de Hidrocarburos (CNH). The new reform measures also allow foreign companies to enter Mexico to process and refine oil, process natural gas, and transport, store and distribute oil, natural gas and derivative products.

The list that PEMEX sent the Ministry of Energy is not public yet but we believe that it includes all of the company's current conventional onshore and offshore oil and gas developments, areas where it has conducted exploration and seismic studies, and areas of major hydrocarbon potential, such as deepwater Gulf of Mexico and non-conventional shale developments. We understand that PEMEX based its selection on its operating expertise, its knowledge of existing oil and gas fields, and its ability to pursue related investments by itself or in association with other oil companies.

We don't expect PEMEX's financial leverage to increase significantly once the government's reform measures open the oil sector to other companies, including foreign ones. PEMEX should retain major positions and new business opportunities in the upstream, midstream and downstream - that is, in exploration and production; oil refining and product marketing, and storage; transportation, and distribution of oil, natural gas, and refined products.

Round Zero gives PEMEX the first rights to explore and produce crude at Mexico's onshore and offshore fields, either alone or in joint ventures with other companies. Under the new legal framework, PEMEX will compete with other companies throughout its upstream and downstream value chain. As a state productive enterprise, PEMEX aims to become a more focused and profitable state oil company in a growing oil and gas industry.

The Ministry of Energy will have 180 days to respond to PEMEX's request. During this period, the Ministry will assign the fields that PEMEX has not chosen--or that the Ministry declines PEMEX's request to keep--through future auction rounds in the open market.
Ministry of Energy will decide which areas go up for auction, and the technical terms of the contracts. In turn, the Ministry of Finance will define the fiscal and economic terms of the contracts, while CNH will oversee the bidding process.

PEMEX will also be able to migrate its assignments to contracts. In the case of projects that are too large or beyond PEMEX's technical or funding capabilities, the company will determine the type of specific expertise from third parties it will need. The Ministry of Energy will then determine the form of partnering with another company that would apply, such as a joint venture, a joint operating agreement, a profit- or production-sharing agreement, or other private arrangement.

PEMEX's monopoly status will gradually change with the implementation of Mexico's energy reform, but the company will still remain Mexico's dominant energy player, with fully integrated operations in oil and gas exploration and production, refining, distribution and retail marketing, pipelines and petrochemicals. PEMEX is also a leading oil exporter, sending about 48% of its crude overseas in 2013, more than three-fourths of it to the US. PEMEX had USD 123 billion in revenues in 2013, including more than USD 52 billion from exports.
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