FITCH AFFIRMS PEMEX'S FOREIGN & LOCAL IDRS AT 'BBB+'/'A-' & NATIONAL SCALE AT 'AAA(MEX)'/'F1+(MEX)'

Fitch Ratings-Chicago-07 May 2015: Fitch Ratings has affirmed Petroleos Mexicanos S.A.'s (Pemex) foreign and local currency Issuer Default Ratings (IDRs) at 'BBB+' and 'A-', respectively. The rating affirmation applies to approximately USD40 billion of notes outstanding. Simultaneously, Fitch has affirmed Pemex National long-term and short term ratings and all related nationally rated debt securities at 'AAA(mex)' and 'F1+(mex)', respectively. The Rating Outlook is Stable.

KEY RATING DRIVERS

Strong linkage to the government

Pemex is the nation's largest company and one of the Mexican central government's major sources of funds. During the past five years, Pemex's transfers to the government have averaged 52.6% of sales, or 108.4% of operating income, and contributions from Pemex have averaged 30% to 40% of government revenues. As a result, Pemex's balance sheet has weakened, which is illustrated by its negative equity balance sheet account since the end of 2009. Despite pari passu treatment with sovereign debt in the past, Pemex's debt currently lacks an explicit guarantee from the government.

Oil production decline stemmed

Currently at approximately 2.3 million barrels per day (bb/d), crude oil production has continued to marginally decline in recent years, although not at the same speed as it did during a precipitous fall in 2008 - 2009. Natural gas production has been relatively stable during recent years at approximately one million barrels of oil equivalent per day (boe/d). Pemex has been able to stem production decline through more intensive use of technology in the Cantarell field, improvements in operations, and increased production from a diversified number of fields. The diversification of the oil production asset base, with Cantarell representing less than 20% of oil production, reduces the risk of large production declines in the future. The company's goal is to increase total crude production to three million bpd in the medium to long-term, which likely will prove challenging as the company's capital spending capacity is constrained by a high tax burden, pension obligations and the currently lower oil price environment.

Energy Reform; Long-term Positive for Pemex

Although Pemex's credit ratings will continue to be highly linked to those of the sovereign, the reform would likely give the company financial flexibility through budgetary independence. Before the implementation of the energy reform, the company budgetary approval process from congress, coupled with high tax burden, hindered the company's investment flexibility. Also, the company would benefit by being able to partner with international oil and gas companies in order to share exploration risk. The overall impact on the reform for Pemex will be positive but gradual and the company will continue to face heavy tax burden in the medium term. The energy reform would also benefit the company's capital structure if it succeeds at restructuring Pemex's high pension liability, which currently impacts its financial profile as pension obligations amounted to approximately USD98.6 billion, or approximately 54% of total adjusted debt at the end of March 2015.

Negative free cash flow due to capex

Fitch expects the company to present negative free cash flow (FCF) over the foreseeable future, considering Fitch's price deck, as it continues to implement sizable capital investments to sustain and potentially increase current production volumes as well as continue of high tax burden. The company's historical significant tax burden has limited its access to internally generated funds, forcing a growing reliance on external borrowings. For the 12-month period ending March 31, 2015, Pemex's funds from operations were approximately USD2.5 billion and net operating cash flow was USD3.1 billion, which compared with cash capital expenditures of USD17.2 billion, resulting in negative FCF of USD14.1 billion.

Strong pre-tax credit metrics

As of 1Q15, Pemex's LTM EBITDA (operating income plus depreciation plus other income) was approximately USD45.7 billion. Leverage as measured by total debt-to-EBITDA was 1.8x and adjusted leverage was 3.4x. Pemex cash flow metrics are weak due to the company's high cash transfers to the government in the form of taxes and production duties. Pemex's FFO adjusted leverage has averaged approximately 9.7x over the past four years and as of 1Q15 stood at approximately 13x.

As of March 31, 2015, total debt was USD84.4 billion which more than double to USD183.1 billion when adjusting for the unfunded pension plan and other post-employment benefits. Positively, Pemex has adequate liquidity of USD8.5 billion as of March 31, 2015. The company has committed revolving credit lines for USD4.5 billion and MXN23.5 billion; as of March 31, 2015 USD 1.55 billion and MXN 3.5 billion were available. The debt is well structured, with manageable short-term debt maturities.

KEY ASSUMPTIONS

Fitch's key assumptions within our ratings case for the issuer include:

--WTI crude prices average USD50 per bbl in 2015, increasing to USD75 per bbl by 2017
--The company continues to face difficulties increasing its production over the next four year
--Transfers to central government continue high at approximately 100% of pre-tax income

RATING SENSITIVITIES

An upgrade of Pemex could result from an upgrade of the sovereign coupled with a continued strong operating and financial performance and/or a material reduction in Pemex's tax burden. Negative rating action could be triggered by a downgrade of the sovereign's rating, the perception of a lower degree of linkage between Pemex and the sovereign, and/or a substantial deterioration in Pemex's credit metrics.

Contact:

Primary Analyst
Lucas Aristizabal
Senior Director
+1-312-368-3260
Fitch Ratings, Inc.
70 W. Madison Street
Chicago, IL 60602

Secondary Analyst
Alberto De Los Santos
Associate Director
+52 81 8399 9100

Committee Chairperson
Daniel R. Kastholm, CFA
Managing Director
+1-312-368-2070

Media Relations: Elizabeth Fogerty, New York, Tel: +1 (212) 908 0526, Email: elizabeth.fogerty@fitchratings.com.

Additional information is available at 'www.fitchratings.com'.

Applicable Criteria and Related Research:
--'Corporate Rating Methodology - Including Short-Term Ratings and Parent and Subsidiary Linkage' (May 28, 2014);
--'Rating Oil and Gas Production Companies' (Aug. 9, 2012).

Applicable Criteria
Corporate Rating Methodology - Including Short-Term Ratings and Parent and Subsidiary Linkage [749393 - 28-MAY-2014] (pub. 28 May 2014)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=749393

Related Research
Rating Oil and Gas Production Companies [682334 - 09-AUG-2012]
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=682334