FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Pemex's IDRs at 'BB-'; Outlook Stable

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Fitch Ratings - New York - 16 Mar 2023: Fitch Ratings has affirmed Petroleos Mexicanos' (PEMEX) Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) at 'BB-'. The Rating Outlook is Stable. The rating action applies to approximately USD80 billion of international notes outstanding.

PEMEX's ratings reflect moderate linkage to Mexico's (BBB-/Stable) credit quality, coupled with a weak Standalone Credit Profile (SCP), which Fitch Ratings believe is commensurate with a 'ccc-'. The SCP reflects PEMEX's elevated and raising leverage levels, limited financial flexibility, high tax burden and high investment needs to maintain production and replenish reserves.

Fitch estimates PEMEX's FCF will average approximately negative USD11 billion per year from 2023 through 2025, as the company seeks to increase capex to revert the historical production decline rate. Fitch believes the company will continue to need significant government support in the near term. The moderate linkage between PEMEX's ratings and those of the sovereign reflects the delay and uncertainty of significant support from the government due to PEMEX's financial difficulties, resulting from high taxes. PEMEX's Stable Rating Outlook mirrors Mexico's sovereign Outlook.

KEY RATING DRIVERS

Linkage to Sovereign Rating: Pemex's ratings are three notches below that of the sovereign. The three-notch differential is in line with Fitch's "Government-Related Entities Rating

Criteria." Per the criteria, Fitch assess four factors: Status, Ownership and Control; Support Track Record and Expectations; Socio-Political Implications of Default; and Financial Implications of Default. The first two factors receive weighting scores as follows: Very Strong (10); Strong (5); Moderate (2.5); and Weak (0). The latter two factors are considered more critical and have designated weightings of Very Strong (20); Strong (10); Moderate (5); and Weak (0).

The accumulated score, coupled with the difference between the SCP ratings of the entity and the sovereign, determine whether the ratings are equalized or rated on a top down basis at 'BBB-' or bottoms up basis at 'ccc-'. PEMEX has a score of 20 and the notch differential is nine, which results in the top down minus three approach. Therefore, Pemex's rating will move in unison with that of the sovereign rating. This is unless the GRE assessment score moves to below 17.5, which would be the result of either Socio-Political Implications of Default and Financial Implications of Default moving from Moderate (2.5) to weak (0). In that case, the rating would shift from a TD-3 to a bottom-up +3, resulting in a 'B-' rating.

Unsustainable Leverage Profile: PEMEX's SCP is aligned with a 'ccc-' credit profile. The company's tax burden is high, even after the decrease in the government profit sharing scheme to 40% from 54% in 2021 and 65% in 2019, and limited financial flexibility to navigate lower oil prices continues to erode its SCP. The SCP reflects PEMEX's elevated leverage and low cash flow from operations, which limits support for sustainable upstream capex that could deliver consistent stable production and 100% reserve-replacement ratios in the long term.

PEMEX's Fitch-defined lease-adjusted EBITDA, before net pension expenses, is estimated to be USD38 billion in 2022 and an FFO of USD9.8 billion, in an environment when its average monomic realized price was USD167boe across its production. Despite the strong pricing environment, the company's FFO leverage, which is the relevant leverage metric for the company given its tax structure, was 11.0x, consistent with the 'CCC' category.

Weak Government Support: Government support has been insufficient and bespoke. Since 2010, Fitch estimates the government supported Pemex through equity injections, and the support averaged 14% of the debt principal repaid in that year. The lack of dependable and meaningful government support through equity injection and a material lowering of government take (taxes and other duties) has resulted in a ballooning of Pemex's debt to USD108 billion in 4Q22 from USD51 billion in 2010, and a CAGR of 6.4%. Over this period, Pemex has reported an average annual cash burn of USD678 million. The government has neglected to provide adequate support to prevent the company from reaching an insolvable debt position or strengthen the cash flow profile, so the company had insufficient cash to fund much needed capex and liquidity.

Cost Profile Pressures Cash Flows: Pemex's high production cost will stress cash flows over the rated horizon, limiting its ability to implement its capex strategy. Fitch estimates that Pemex has the highest full-cycle cost of production in the region. In 2022, Pemex's half-cycle cost of production, which is operating costs plus interest expense, was USD32.6 boe, where interest expense was USD12.2boe. The company's full-cycle cost of production, which is half-cycle plus three-year average FD&A for 1P and taxes, royalties, and other government duties, was USD79.3. Government take was USD35.1 boe and FD&A of 1P was at a competitive US10boe.

As prices decrease to USD53bbl after 2025, per Fitch's price deck, Pemex's cash flow profile will be pressured by a higher cost of debt, high government take, and elevated capex. Fitch's rating case is not assuming any support, resulting in an average annual negative FCF of USD8.2 billion between 2023-2024 when assuming an average annual capex of USD8.5 billion during the same period. This coupled with addressing a total debt amortization of USD24.0 billion, pressures the government to provide more meaningful support.

DERIVATION SUMMARY

PEMEX's linkage to the sovereign compares unfavorably with peers Petroleos Brasileiro S.A. (Petrobras; BB-/Negative), Ecopetrol S.A. (BB+/Stable), Empresa Nacional del Petroleo (ENAP; A-/Stable) and Petroleos del Peru - Petroperu S.A. (BBB-/Negative Watch). All of PEMEX's regional peers have strong linkages to their sovereigns due to strong government support. Fitch believes governments in the region, except for Mexico, implemented different measures to ensure the SCPs of their respective national oil and gas companies remain viable in the long term.

PEMEX's ratings continue to reflect its close, albeit deteriorating, linkage to the Mexican government due to its fiscal and strategic importance. The ratings also reflect the company's competitive pre-tax cost structure, national and export-oriented profile, sizable hydrocarbon reserves and strong domestic market position. The ratings are constrained by PEMEX's substantial tax burden, high leverage, significant unfunded pension liabilities, large capital investment requirements, negative equity and exposure to political interference risk.

Fitch views PEMEX's SCP as commensurate with a 'ccc-', which is 10 notches below Petrobras' and Ecopetrol's SCPs of 'bbb'. The differences are primarily due to PEMEX's weaker capital structure and increasing debt and leverage trajectory. PEMEX's SCP reflects the company's large transfers to Mexico's federal government, large and increasing financial debt balance when compared with 1P reserves and elevated EBITDA-adjusted leverage. Comparatively, Ecopetrol and Petrobras significantly strengthened their capital structures and maintained stable operating profiles.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within The Rating Case for the Issuer:

--Average West Texas Intermediate crude prices of USD95/bbl in 2022 and trending toward USD50/bbl in the long term;

--Upstream capex moderately increases to USD8.0 billion per annum;

--Production continuing its stabilization trend at 1.9mmboed;

--PEMEX will receive necessary support from the government to ensure adequate liquidity and debt service payments;

--Profit sharing duty rate of 40% per annum.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--An upgrade of Mexico's sovereign ratings;

--An irrevocable guarantee from Mexico's government to sustainably cover more than 75% of PEMEX's debt;

--A material capitalization, coupled with a material reduction of taxes, with a business plan that results in neutral to positive FCF through the cycle, while implementing sustainable upstream capex that is sufficient to replace 100% of reserves and stabilize production profitably;

--Sustainable FFO leverage below 5.0x and/or Gross Leverage of 4.0x.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--A downgrade of Mexico's sovereign rating;

--A sustained deterioration of PEMEX's financial flexibility, coupled with government inaction to support liquidity, potentially resulting from continued negative FCF or a material reduction of cash on hand, credit facilities and restricted capital markets access.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

LIQUIDITY AND DEBT STRUCTURE

Weak Liquidity: PEMEX's liquidity position remains weak as a result of negative FCF, which resulted in a relatively low cash position and reduced availability of its lines of credit. PEMEX reported total cash and equivalents of around USD3.72 billion as of YE 2021. Its liquidity compares unfavorably with principle debt amortizations of USD8.2 billion due in 2022.

Fitch expects PEMEX will require material external funding in 2023 through 2024, given expected negative FCF resulting from a high tax burden under Fitch's price assumptions for oil. Absent capital increases from the Mexican government, PEMEX is likely to continue funding its negative FCF with debt and potentially further erode liquidity.

ISSUER PROFILE

PEMEX, Mexico's state oil and gas company, is the nation's largest company and ranks among the world's largest vertically integrated petroleum enterprises.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Fitch has revised PEMEX's ESG Relevance Score for GHG Emissions & Air Quality to '4' from '3' due to the growing importance of the continued development and execution of the company's energy-transition strategy. This has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

PEMEX has an Environmental, Social and Governance (ESG) Relevance Score (RS) of '4' for Governance Structure, resulting from its nature as a majority government-owned entity and the inherent governance risk that arises with a dominant state shareholder, which has a negative impact on the credit profile and is relevant to the ratings in conjunction with other factors.

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Petroleos Mexicanos (PEMEX)	LT IDR	BB- Rating Outlook Stable	Affirmed	BB- Rating Outlook Stable
	LC LT IDR	BB- Rating Outlook Stable	Affirmed	BB- Rating Outlook Stable
senior unsecured	LT	BB-	Affirmed	BB-

VIEW ADDITIONAL RATING DETAILS

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PARTICIPATION STATUS

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APPLICABLE CRITERIA

Government-Related Entities Rating Criteria (pub. 30 Sep 2020)

Parent and Subsidiary Linkage Rating Criteria (pub. 01 Dec 2021)

Corporate Rating Criteria (pub. 28 Oct 2022) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Petroleos Mexicanos (PEMEX)	EU Endorsed, UK Endorsed

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UNSOLICITED ISSUERS

ENTITY/SECURITY	ISIN/CUSIP	RATING TYPE	SOLICITATION STATUS
Petroleos Mexicanos (PEMEX)	-	Long Term Issuer Default Rating	Unsolicited
Petroleos Mexicanos (PEMEX) senior unsecured bond/note	US71654XAK37	Long Term Rating	Unsolicited
Petroleos Mexicanos (PEMEX) senior unsecured program – medium term note	US71656MAF68	Long Term Rating	Unsolicited
Petroleos Mexicanos (PEMEX) PEMEX 13-2 ser 2013	MX95PE1X00H9	Long Term Rating	Unsolicited

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