FitchRatings

RATING ACTION COMMENTARY

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

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Fitch Ratings - New York - 24 Mar 2022: 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.

Petroleos Mexicanos' (PEMEX) 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. We believe 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

Weak Underlying Credit Quality: PEMEX's SCP is aligned with a 'ccc-' credit profile, were it not state owned and receiving government support. The company's high tax burden, even after the decrease in the government profit sharing scheme to 40% from 54%, 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 preliminarily reported Fitch-defined lease-adjusted EBITDA, before net pension expenses, of approximately USD23.3 billion in year-end 2021, and FFO of around USD4.3 billion, up from USD7.6 billion and negative USD4.5 billion, respectively in 2020. Total financial debt amounted to about USD110.0 billion down slightly from USD113 billion in 2020, translating into total debt/EBITDA of approximately 4.7x. The SCP reflects the company's low liquidity position, with only USD3.7 billion of cash on hand, as of December 2021.

Transfers Weaken SCP: PEMEX's weak underlying credit quality is primarily the result of excessive distributions to the government. Contributions to Mexico averaged about 11.6% of government revenue between 2015 to 2019, although they declined to around 4.9% in 2020 due to lower oil prices, but reverted up to 8.4% in 2021. Transfers from PEMEX to the government remain high, relative to the company's cash flows, as transfers were approximately 25% of sales during the past three years, or about 80%-100% of adjusted EBITDA in 2019 and 2021. The government lowered the cash taxes in 2021 to 40%, which represented nearly 60% of EBITDA in 2022 and 2023. The company's balance sheet remains weakened, and its debt lacks an explicit guarantee from the Mexican government.

Weak Government Support: Mexico has demonstrated weak support for PEMEX through delayed implementation of measures to alleviate the company's credit quality deterioration. This weak support assessment also reflects high levels of transfers from PEMEX to the government. Fitch believes the government might continue to provide meaningful support if necessary.

Total government support for PEMEX was about USD15.4 billion in 2020 in the form of tax credits and capital injections, of which more than USD3.5 billion per year was earmarked for liability management. This support includes a previously announced tax reduction of 7% in 2020 and a further 4% relief in 2021. Net transfers from PEMEX to the government amounted to about USD13.5 billion after tax credits in 2021. Mexico announced further tax credits for 2022, lowering cash tax obligations to 40% from 54% in 2021. Fitch expects this level to remain through the rating horizon, averaging USD17 billion per annum.

Moderate Government Linkage: We expect the government will ensure PEMEX maintains sufficient liquidity to service debt, despite the moderate rating linkage, which supports the material rating uplift from the SCP. Fitch assesses government support for PEMEX as weak and government incentives sub-factors as moderate. We view Mexico's ownership and control of PEMEX as very strong.

This assessment results in a three-notching differential between PEMEX and Mexico's ratings. The Mexican government has strong incentives to support PEMEX, given the socio-political and financial consequences of a default for the country. It is Mexico's largest company and one of the government's major sources of funds, with material contributions to government revenues.

Strategic Importance for Energy Security: The sovereign linkage stems from the company's strategic importance in supplying liquid fuels to Mexico. A financial crisis at PEMEX could potentially disrupt the country's liquid fuel supply. Mexico is a net importer of liquid fuels due to low refinery utilization rates. The country relies on PEMEX for almost all of its supply of gasoline and diesel, about 52.5% of which is from imports. Financial distress at PEMEX could also have very severe financial consequences for the Mexican government and other government-related entities, especially regarding access to funding.

Continued Upstream Underinvestment: Fitch expects production and reserves to remain stable over the rating horizon, should PEMEX continue increasing exploration and production (E&P) capex, while reducing lifting, finding and development (F&D) costs. We estimate projected capex will likely be insufficient to sustainably replenish 100% of reserves without further reducing F&D costs, as the company would require annual E&P capex of about USD12 billion to replenish 100% of 1P reserves on a sustainable basis. This is based on a F&D and acquisition cost estimate of USD13.00/boe and annual production of 900 million boe/year.

PEMEX's crude oil production stabilized in the past 24 months at about 1.7 million barrels per day (bpd) after decades of continued declines. Fitch assumes total production may remain stable over the rating horizon as the company's increase in capex may only be sufficient to offset production declines from mature fields. PEMEX's production from new fields increased by around 322,000 bpd as of December 2021, which helped offset declines in production from mature fields.

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-/RWN). 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 Our 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 continues to be 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 aroundUSD3.6 billion as of year-end

2021. Its liquidity compares unfavorably with principle debt amortizations of USD7.5 billion due in 2022.

Fitch expects PEMEX will require material external funding in 2022 through 2024, given expected negative FCF resulting from a high tax burden under our 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.

SUMMARY OF FINANCIAL ADJUSTMENTS

Fitch adjusted PEMEX's EBITDA to add back non-cash pension expenses.

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.

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

PEMEX's ratings are directly linked to the sovereign rating.

ESG CONSIDERATIONS

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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APPLICABLE CRITERIA

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

Corporate Rating Criteria (pub. 15 Oct 2021) (including rating assumption sensitivity)

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

APPLICABLE MODELS

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

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 (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) senior unsecured bond/note	US71654XAK37	Long Term Rating	Unsolicited
Petroleos Mexicanos (PEMEX) senior unsecured program – other	US71656MAF68	Long Term Rating	Unsolicited

ENTITY/SECURITY	ISIN/CUSIP	RATING TYPE	SOLICITATION STATUS

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