MOODY'S
INVESTORS SERVICE

Rating Action: Moody's downgrades PEMEX's ratings to Ba2; negative outlook

17 Apr 2020

New York, April 17, 2020 -- Moody's Investors Service (Moody's) downgraded Petroleos Mexicanos' (PEMEX) senior unsecured ratings on the company's existing notes, as well as the ratings based on PEMEX's guarantee, to Ba2 from Baa3. Simultaneously, Moody's withdrew PEMEX's Baa3 issuer rating and assigned a Ba2 corporate family rating to the company. Moody's also lowered PEMEX's Baseline Credit Assessment (BCA), which reflects its standalone credit strength, to caa2 from caa1. These rating actions were triggered by the company's higher liquidity and business risk and by Moody's announcement on April 17, 2020 that it had downgraded its ratings on the Government of Mexico's to Baa1 from A3 and maintained the negative outlook on the government's ratings. The outlook on Pemex's ratings remains negative.

"We downgraded PEMEX's ratings and maintained the negative outlook on its ratings following the downgrade of Mexico's rating and its negative outlook given the critical importance of the government's financial strength and support in the assessment of PEMEX's credit risk," commented Nymia Almeida, Moody's Senior Vice President. "The actions took in consideration our expectations for an extended period of negative free cash flow and the need for external funding, despite the company's efforts to adjust costs and investments to low oil prices."

Ratings downgraded as follows:

Downgrades:

..Issuer: Petroleos Mexicanos

....Gtd Senior Unsecured Medium-Term Note Program, Downgraded to (P)Ba2 from (P)Baa3

....Gtd Senior Unsecured Regular Bond/Debenture, Downgraded to Ba2 from Baa3

..Issuer: Pemex Project Funding Master Trust

....Gtd Senior Unsecured Medium-Term Note Program, Downgraded to (P)Ba2 from (P)Baa3

....Gtd Senior Unsecured Regular Bond/Debenture, Downgraded to Ba2 from Baa3

Withdrawals:

..Issuer: Petroleos Mexicanos

.... Issuer Rating, previously rated Baa3

Assignments:

..Issuer: Petroleos Mexicanos

.... Corporate Family Rating, Assigned Ba2

Outlook Actions:

..Issuer: Petroleos Mexicanos

....Outlook, Remains Negative

..Issuer: Pemex Project Funding Master Trust

....Outlook, Remains Negative

RATINGS RATIONALE

PEMEX's Ba2 corporate family rating and caa2 BCA reflect the company's high vulnerability to low commodities prices given its fragile liquidity position and excessive debt burden. Between mid 2019 and early 2020, management was able to stabilize oil production and refinance debt. However, PEMEX's cash flow generation and credit metrics will remain weak in the foreseeable future as the company grapples with low oil prices, high debt maturities, and underinvestment in exploration and production in favor of an expansion of its refining business, which has generated losses for several years.

Moody's believes that PEMEX's need for external funding to cover negative free cash flow will increase as a consequence of the company's limited ability to improve its business results due to the mature stage of oil fields; shortage of capital to sufficiently invest in exploration and production, with negative consequences in production and reserve replacement; and the mandate to expand the refining business, which Moody's expects will continue to post operating losses and be vulnerable to the oil and gas industry medium-term demands trends. PEMEX's management believes that the company was able to replace proved reserves at a rate of 120% in 2019; however, it is unlikely that the company will be able to replace reserves at a rate equal or close to 100% in 2020-21 given weak cash generation and limited access to capital.

The rapid and widening spread of the coronavirus outbreak, deteriorating global economic outlook, falling oil prices, and asset price declines, are creating a severe and extensive credit shock across many sectors, regions and markets. The combined credit effects of these developments are unprecedented. The oil and gas sector has been one of the sectors most significantly affected by the shock given its sensitivity to consumer demand and sentiment. More specifically, the weaknesses in PEMEX's credit profile has left it vulnerable to shifts in market sentiment in these unprecedented operating conditions and PEMEX remains vulnerable to the outbreak continuing to spread. We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety.

PEMEX's Ba2 ratings take into consideration Moody's joint default analysis, which includes the rating agency's assumptions of very high government support in case of need and very high default correlation between PEMEX and the Government of Mexico, resulting in six notches of uplift from the company's caa2 BCA. Since 2016, the government has supported PEMEX in various ways, including capital injections, tax reductions and early redemption of notes receivable from the government. The government has most recently announced a reduction in PEMEX's taxes by $2.6 billion in 2020 and Moody's base assumption is that the Mexican government will provide support to help fund PEMEX's negative free cash flow. The company will have to increase debt in 2020 in order to invest to meet the government's and PEMEX's revised objective of maintaining production stable from 2019 levels.

PEMEX has weak liquidity and is highly dependent on government support. At December 31, 2019, PEMEX had $3.2 billion of cash and currently has $8.9 billion in unused committed revolving credit facilities to address over $8 billion in debt maturities in 2020-21 besides negative free cash flow of over $9 billion in the period, as estimated by Moody's.

The negative rating outlook on PEMEX's Ba2 ratings coincides with the negative outlook on Mexico's Baa1 rating given the importance of the sovereign's credit strength and ongoing support to PEMEX's ratings.

Mexico's negative outlook reflects the risk that economic and fiscal strength deteriorate beyond what is captured in a Baa1 rating due to the continuing absence of policies that can effectively address the country's economic challenges and Pemex's continued financial and operating problems. For further information, including factors that could drive Mexico's rating up or down, refer to the rating action press release: https://www.moodys.com/research/Moodys-downgrades-Mexicos-ratings-to-Baa1-maintains-negative-outlook--PR_422013

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATING

A downgrade of Mexico's Baa1 rating would likely result in a downgrade of PEMEX's rating. In order for Moody's to consider an affirmation of PEMEX's Ba2 rating following a sovereign downgrade, the company's BCA would have to substantially improve. Factors that could drive a higher BCA would be the ability of the company to strengthen its liquidity position and ideally internally fund sufficient capital reinvestment to fully replace reserves and deliver modest production growth, and generate free cash flow for debt reduction. Because PEMEX's ratings are highly dependent on support from the government of Mexico, a change in assumptions about government support and its timeliness could lead to a downgrade of PEMEX's ratings.

A lowering of the BCA could also lead to a downgrade of PEMEX's ratings. Factors that could lead to a lower BCA include material increase in net debt, an operating performance worse than forecasted, reserves declines and decreases in reserves life.

An upgrade is unlikely given the negative outlook for Mexico's Baa1 rating and Moody's expectations for continued negative free cash flow at PEMEX.

The methodologies used in these ratings were Integrated Oil and Gas Methodology published in September 2019 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1172345 , and Government-Related Issuers Methodology published in February 2020 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1186207 . Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of these methodologies.

Founded in 1938, PEMEX is Mexico's national oil company, with fully integrated operations in oil and gas exploration and production, refining, distribution and retail marketing, as well as petrochemicals. PEMEX is also a leading crude oil exporter, around 60% of its crude is exported to various countries, mainly to the US and Asia. In the twelve months ended December 31, 2019 the company produced an average of 1,703 thousand barrels of per day of crude oil (excluding partners).

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1133569 .

At least one ESG consideration was material to the credit rating action(s) announced and described above.

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