MOODY'S
INVESTORS SERVICE

Rating Action: Moody's downgrades PEMEX's ratings to B1; outlook changed to stable

11 Jul 2022

New York, July 11, 2022 -- Moody's Investors Service (Moody's) downgraded Petroleos Mexicanos' (PEMEX) corporate family rating and the senior unsecured ratings on the company's existing notes, as well as the ratings based on PEMEX's guarantee, to B1 from Ba3. Moody's also affirmed PEMEX's Baseline Credit Assessment (BCA), which reflects its standalone credit strength, at caa3. These rating actions were triggered by Moody's announcement on July 8, 2022 that it had downgraded its ratings on the Government of Mexico's to Baa2 from Baa1 and changed the outlook on the government's ratings to stable from negative. The outlook on Pemex's ratings is now stable.

Affirmations:

..Issuer: Petroleos Mexicanos

.... Baseline Credit Assessment, Affirmed caa3

Downgrades:

..Issuer: Petroleos Mexicanos

....Corporate Family Rating, Downgraded to B1 from Ba3

....Senior Unsecured Medium-Term Note Program, Downgraded to (P)B1 from (P)Ba3

....Senior Unsecured Regular Bond/Debenture, Downgraded to B1 from Ba3

..Issuer: Pemex Project Funding Master Trust

....Senior Unsecured Medium-Term Note Program, Downgraded to (P)B1 from (P)Ba3

....Senior Unsecured Regular Bond/Debenture, Downgraded to B1 from Ba3

Outlook Actions:

..Issuer: Pemex Project Funding Master Trust

....Outlook, Changed To Stable From Negative

..Issuer: Petroleos Mexicanos

....Outlook, Changed To Stable From Negative

RATINGS RATIONALE

The downgrade on PEMEX's ratings to B1 from Ba3 was prompted by the downgrade of Mexico's rating, given the critical importance of the government's financial strength and support in the assessment of PEMEX's credit profile due to its high liquidity risk. The action also considered PEMEX's high debt maturities in 2022-24 and Moody's expectations for continued negative free cash flow and the need for large amounts of external funding given persistent loses at the company's refining business, the necessity to maintain capex at least at current levels to sustain production and reserves stable, and high interest expenses. The action also took into account that PEMEX's access to the capital markets is currently limited given its high intrinsic credit risk.

Elevated oil prices in 2022-23 in comparison with 2020-21 levels will support higher cash generation at PEMEX's exploration and production (E&P) business in the period but will simultaneously increase royalties and operating costs at the refining business. Although oil and gas production growth has been below management targets, it is positive that, since 2019, PEMEX has been successful in maintaining production and reserves relatively stable. However, Moody's estimates that, in 2022-24, the company will only be able to sustain production and reserves at current levels given its inability to invest larger sums of capital in E&P.

PEMEX's B1 rating takes 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 five notches of uplift from the company's caa3 BCA. Since 2016, and most importantly and increasingly from 2019 to 2021, the government has supported PEMEX in various ways, including capital injections, tax reductions, and early redemption of notes receivable from the government. Moody's assumes that the government, as promised, will continue to fund PEMEX's cash needs and help the company to comply with its debt amortization obligations of $5.1 billion in 2022, $7.5 billion in 2023, and $8.9 billion in 2024, as of March 2022.

PEMEX has weak liquidity and is highly dependent on government support. On March 31, 2022 the company had $2.4 billion in cash and no availability under its committed revolving credit facilities to address debt maturities. In addition, Moody's estimates that PEMEX will have substantial negative free cash flow in the next 12-18 months, driven by insufficient operating cash generation to pay interest expenses, taxes, and capital spending.

The stable outlook on PEMEX's ratings is based on Moody's expectation that the company's business strategy and financial profile will remain unchanged in the next 12-18 months; it also considers the current stable outlook on Mexico's ratings.

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

A downgrade of Mexico's Baa2 rating would likely result in a downgrade of PEMEX's rating. For an affirmation of PEMEX's B1 rating following a sovereign downgrade, the company's BCA would have to substantially improve. Because PEMEX's rating is highly dependent on support from the Government of Mexico, a change in Moody's assumptions about government support and its timeliness could lead to a downgrade of PEMEX's rating. A lowering of the BCA could also lead to a downgrade of PEMEX's rating. Factors that could lead to a lower BCA include material increases in net debt, an operating performance worse than forecasted, reserve declines and decreases in reserve life.

Conversely, an upgrade of Mexico's Baa2 rating could result in an upgrade of PEMEX's rating given the importance of the government in providing support to the company's liquidity needs. In addition, factors that could lead to a higher BCA and potentially a higher rating for PEMEX would include its ability to strengthen its liquidity position and internally fund sufficient capital reinvestment to fully replace reserves, deliver modest production growth and generate free cash flow for debt reduction.

ENVIRONMENTAL, SOCIAL, AND GOVERNANCE CONSIDERATIONS

PEMEX's ESG Credit Impact Score is very highly negative (CIS-5). In addition to having very high environmental risk exposure and high social risk exposure, PEMEX has very high governance risk, including weak financial strategy and risk management, weak board structure, and policies and procedures.

PEMEX has a very highly negative exposure to environmental risk (E-5 Issuer Profile Score) mainly driven by very high carbon transition risk, high natural capital risk, high water management risk, and high waste and pollution risk. Integrated companies with high exposure to upstream business will face increasing pressure over time, particularly oil producers, as decarbonization efforts and the transition towards cleaner energy continues.

PEMEX has a very highly negative exposure to social risks (S-5 Issuer Profile Score) mainly driven by health and safety, responsible production, and demographic & societal pressures. Other drivers include weak customer relations and high human capital risk.

Governance risks are very highly negative (G-5 Issuer Profile Score) and linked primarily to financial strategy and risk management, in addition to board structure, policies and procedures, and track record. There is very high risk related to liquidity and leverage. PEMEX has significant ownership concentration.

The methodologies used in these ratings were Integrated Oil and Gas Methodology published in September 2019 and available at https://ratings.moodys.com/api/rmc-documents/64319 , and Government-Related Issuers Methodology published in February 2020 and available at https://ratings.moodys.com/api/rmc-documents/64864. Alternatively, please see the Rating Methodologies page on https://ratings.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 three months ended March 31, 2022 the company produced an average of 1,755 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 on https://ratings.moodys.com/rating-definitions.

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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://ratings.moodys.com/documents/PBC_1288235.

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