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TALANZA

Regions in risk of default with the new Storage Policy

Starting in July 2020, fuel distributors and traders will have to increase inventories until they reach an average of 5 days of sales of gasoline and diesel and 1.5 days of sales of jet fuel, to comply with the Public Policy on Minimum Fuel Inventories (the Policy) published by the Ministry of Energy (SENER).

We conducted a regional analysis with public information, considering the Policy's regionalization. Said analysis reveals the impossibility for some traders and distributors to comply with the requirements of the Policy, particularly those from regions with higher storage infrastructure deficit, like Central and West.

INVENTORY CURRENT STATUS:

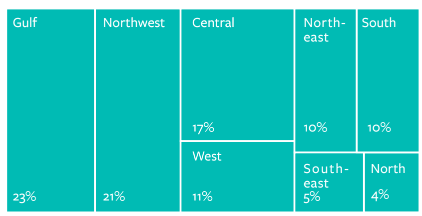
To help the continuity of supply and the logistics associated with the market in case of an emergency, the Policy establishes that at least 50% of the minimum inventories should be stored in terminals that usually supply traders or distributors by auto-tank (strategic reserve). The remaining minimum inventories could be placed in any other terminal in the country, through the acquisition of tickets. A regional analysis of existing inventories and demand shows the following findings:

REGIONAL INVENTORY REVIEW:

Most Mexican actual physical inventory is in the Gulf region, followed by the Northwest and Central regions. Together, these three areas concentrate more than 60% of the stock.

Gulf and Northwest regions concentrate most of the gasoline and diesel inventory while Central and Southeast regions concentrate most of the jet fuel inventory.

Fuel inventory status per Region (first week of May 2020)



Source: Own elaboration based on data of the Ministry of Energy
https://estadisticashidrocarburos.energia.gob.mx/Inventarios.aspx

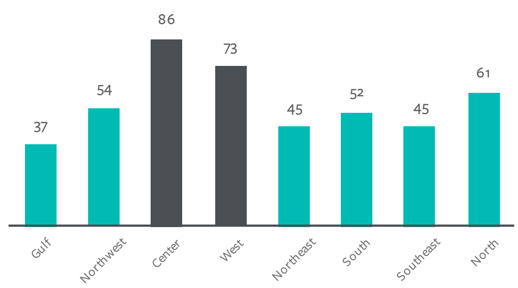
DEMAND:

From a demand point, the Central and West regions have the highest gasoline and diesel consumption. Meanwhile, Central and Northeast regions group 84% of the jet fuel consumption. However, these regions, with the highest fuel demand, do not show the uppermost level of inventories. CRE's permits database reports that the storage infrastructure in the Central and West regions is insufficient to comply with the strategic reserve.

For Permit Holders in the Central region to comply, on average, each existing terminal would have to serve up to 86 service stations and an average of 73 in the West region, which seems highly unlikely.

Therefore, without more terminals ready to commence operations close to the points of consumption, many traders and distributors will not be able to comply with the strategic reserve.

Number of service stations per storage terminal



Source: Own elaboration based on CRE's public data

WHAT IF YOU CAN NOT FULFILL THE MINIMUM STOCK OBLIGATION?

Each company, in compliance with its values, philosophy, and risk management, may consider various strategies to deal with this situation. Here are a few:

1. Survival of the fittest. Prices will raise, those who can pay more for a scarce service will get it.
2. Prepare a legal strategy. Permit Holders may argue how circumstances beyond their control and responsibility prevent them from complying with part of the Policy.
3. Pay the penalty when CRE imposes the fine. The latter may be challenged given the lack of infrastructure.

TICKETS

Tickets are leasing agreements for stockholding in which the seller reserves an amount of fuel on behalf of the buyer for a fee. The ticket buyer has the option to take delivery of physical stocks in times of crisis, according to conditions specified in the contract. The rationale behind stock tickets is that a company holding stocks over its obligation can offer them to cover another company's obligation.
Permit Holders can have 50% of their capacity and inventories in terminals other than where they usually purchase their product, by acquiring tickets from a third party.

PEMEX TRI

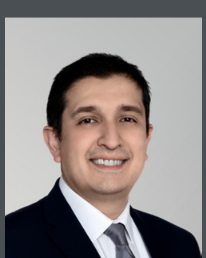
PEMEX TRI (Petróleos Mexicanos subsidiary) has excess capacity on several regions, and therefore, will have a leading position in the tickets market.
Considering that 85% of the storage terminals belong to Pemex TRI, traders and distributors without enough storage capacity may have to purchase tickets from this state-owned company.

CONSIDERATIONS

1. The guidelines for ticket emission are pending. The project should be subject to public consultation through the *Comisión Nacional de Mejora Regulatoria.*
2. CRE presents delays in the analysis of several storage projects and permit requests, which enhance the scarcity of infrastructure. This will lead to higher ticket prices.
3. The Policy is subject to review at least every five years, or at any time if SENER seeks an adjustment. Still, it seems unlikely that authorities will consider delaying the entering into effect of this Policy any further, given that Pemex TRI complies and will be able to profit from other Permit Holders' needs.
4. Permit Holders must define a regulatory strategy to continue operations and avoid penalties.

In Talanza, we advise Permit Holders and interested firms in finding mechanisms for new oil storage projects to commence operations as soon as possible: obtaining permits, tariffs, and terms & conditions.

ANALYSTS



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We are a unique firm integrated by experts in energy regulation and public administration, conformed by a professional team with vast experience in the evolution of the energy sector during the last 10 years.

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