

Pemex's farm-outs: The big opportunity

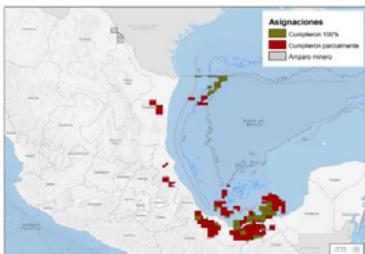
In February's one-pager, we stated that López Obrador's administration will realize sooner or later of the necessity of private investment in upstream activities just as the two former administrations did during the last 12 years. Today, we believe that "sooner" will prevail as we have identified clear signals that farm-outs will be reopened soon representing a major opportunity for oil and gas operators as Pemex has been struggling in developing the largest oil and gas potential in Mexico.

1.- PEMEX'S CURRENT FINANCIAL, TECHNICAL AND MANAGEMENT CAPABILITIES

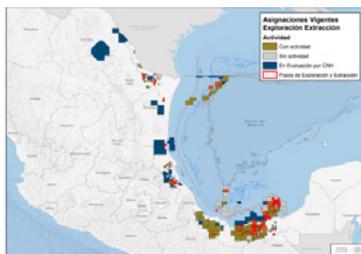
In August 2014, Pemex was awarded with 83% of Mexico's 2P Reserves and 21% of Estimated Resources through a process known as Round Zero regulated by the Mexican Constitution where Pemex should request only the areas for which it has financial, technical and management capabilities. This request was evaluated by the Ministry of Energy ("SENER") and the National Hydrocarbons Commission ("CNH") and, as a result, Pemex was awarded with 489 blocks (108 for exploration and 381 for extraction).

After five years and 72 entitlements modified, it is clear that Round Zero was too much for Pemex to handle. According to SENER, by the end of 2018, 65 of 101 exploratory entitlements have not fulfilled their work commitments and 136 of 259 extraction entitlements have no activities.

Only 36 of 101 exploration entitlements fulfilled work commitments (green)



Only 27% of E&P entitlements had activities during 2015-2017 (red)



Pemex's financial, technical and management capabilities were insufficient to stop declining production and to maintain 2P reserves awarded in Round Zero (20,589 mmbob in 2014 drop 34% by 2018).

2.- FARM-OUTS, THE BEST AND ONLY SOLUTION TO INCREASE PEMEX'S EXECUTION CAPABILITIES

Last week, CNH approved an ultra-deep-water drilling permit to Pemex's Block 5 of Perdido Area of Round 2.4. Since Pemex has no experience in deep water development, it will be necessary to farm-out this block in case it confirms a commercial discovery. This is a positive signal that government will reactivate farm-outs soon. However, this benefits would come in the long run and the government requires results in the short run as it needs to increase production by 700,000 barrels per day in 5 years.

Considering that CAPEX of the last 10 years (average of 17 billion from 2009 to 2015 and an average of 10 billion from 2016 to 2019) was not enough to stop declining production; it seems impossible to achieve short run results unless Pemex starts farming-out fields in development and production stages in shallow water and onshore, where there is a vast potential of more than 20,000 mmbob in 3P reserves.

Farm-outs would represent the greatest opportunity for private investors to partner with Pemex and, for the government, to achieve its goals. With an adequate approach, oil and gas industry could persuade the government that this is an excellent opportunity to relaunch an Energy Reform 2.0, where farm-outs and Pemex would become central.

PRIVATE OPERATORS IN MEXICO HAVE A GOOD CHANCE TO INFLUENCE THE PROCESS OF REACTIVATING FARM-OUTS. HERE SOME OF OUR SUGGESTIONS:

- Government should recognize that Pemex has a big space to improve and that by partnering with key operators it could increase not only money but also technical and management capabilities.
- One way to start could be to establish technical workshops to show Pemex and government agencies the advantages of partnerships.
- It would be crucial to approach government and Pemex to present new technologies for increasing production and reserves rapidly in specific projects where Pemex has not obtained good results (e.g. deep water, EOR-IOR, shale, Chicontepec, marginal fields, others).
- Government must recognize that service contracts like CSIEEs will not maximize investments, production nor oil rent.
- Industry can help Pemex and government to review the terms and conditions of its JOA to increase competition in farm-out's tenders.
- Finally, Pemex's farm-outs are consistent with the political intention of Pemex's mission of rescuing energy sovereignty.

Thanks to our Regulatory and Governmental Intelligence approach, we have been successful in supporting our clients in the integral risk assessment (political, legal financial, social and environmental) of their activities in Mexico. We also advise and guide our clients in their interactions with government increasing effectiveness in their governmental affairs.

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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