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Mayer Brown's 9th Annual Global Energy Conference

**PANEL III: ENERGY IN MEXICO: WHAT TO EXPECT –
ECONOMIC AND POLITICAL IMPACT OF THIS
EMERGING OIL MARKET**






Mayer Brown May, 2014




Jordy Herrera

Mexico's Energy Sector

Facts

- 1P Reserves: + 100 % replacement (+- 11 years) 
- Oil Production: + 2.5 mbd (4th consc. yr) 
- Gas Production: + 5.6 bcfd 

- Power Capacity: + 63 Thousand MW
- Renewable Capacity: + 24 % (2012)

- Net Imports (fuels)
 - Natural Gas: +- 1.4 bcfd (20% demand) 
 - Gasoline: +- 400,000 bd (50% demand) 
 - LPG: +- 80,000 bd (30 % demand) 

Mexico's Energy Reform

Brief history

- 2008 Energy Reform several Legal Reforms
 - National Energy Strategy
 - Specific Law for PEMEX
 - Performance Contracts (Incentivized)
 - National Hydrocarbon Commission
 - Renewable Energy and Climate Change specifics laws
- 2013 Constitutional Reform
 - Different from the Official Initiative (PRI), closer to PAN 's
 - New Industry Arrangement
 - Allows Public and Private Companies to participate in:
 - Upstream, Midstream, Downstream and Power Generation
- 2014 Legal Reform
 - More than 20 different modifications, mainly fiscal and regulatory
 - Green Laws to be added

Mexico's Energy Reform

The basic scheme

- Upstream (Exploration and Production)
 - Energy Ministry decides when and where
 - Signs the contracts as representative of the Mexican State
 - NHC (CNH) decides how (any type of new contract, fiscal terms)
 - Calls out for a bid: for current and also new developing areas
 - Round Cero for PEMEX, those areas that PEMEX can
 - Current Developments
 - PEMEX could hire (through new contracts) private companies
 - Farm Out is an exception
 - Public International Bids for new developing areas
 - Those areas where PEMEX was not approved or declined
 - New developing areas
 - Unconventional
 - Deep Water
 - Private Companies can participate, alone or through JV's

Mexico's Energy Reform

The basic scheme (2)

- Sovereign Fund
 - Income and other common taxes will go to Treasury Ministry
 - All the income coming from specific taxes and contributions related with E&P will go to a new entity:
 - State Owned Fund named : Fondo Mexicano del Petróleo,
 - hosted in BANXICO (Central Bank)
 - The money within the Fund will be used mainly for:
 - Contingency money for government income, such as:
 - drops in oil prices, lowering public income, ...
 - Long term public savings:
 - If above 3 % GDP then it could be used for:
 - Universal Retirement funds
 - Energy R+D public institutions, to promote Renewable Energy
 - Oil and Gas specific projects, infrastructure in general
 - Scholarships, connectivity and regional growth
 - In any case it can not be used in the common public spending

Mexico's Energy Reform

The basic scheme (3)

- Midstream (Transportation, Distribution & Storage)
 - PEMEX will keep all the infrastructure with the exception of natural gas pipelines
 - A new State Owned Company
(Centro Nacional de Control del Gas Natural) will be created to operate the natural gas pipeline system, different from PEMEX or even PEMEX GAS
 - PEMEX could hire any private company (through new contracts)
 - Private companies can participate in association with PEMEX
 - Private companies can participate directly

Mexico's Energy Reform

The basic scheme (4)

- Downstream
 - PEMEX will keep all the infrastructure
 - PEMEX could hire any private company (through new contracts)
 - Private companies can participate in association with PEMEX
 - Private companies can participate directly

Mexico's Energy Reform

The basic scheme (5)

- Main changes.
 - New role for Energy Ministry (National Planner)
 - Broader new types of contracts between the State with private companies (incentivized, production sharing, profit sharing, licenses)
 - PEMEX can also use the same ones to hire other companies
 - Fondo Mexicano del Petróleo (Sovereign Fund)
 - New responsibilities and specific legal scheme for the regulators both NHC and REC (CNH, CRE)
 - Transformation of the State Owned Companies into a new legal scheme named Productive Public Companies (EPE)
 - PEMEX is losing the natural gas pipeline system
 - CFE is losing the electrical system operation
 - New and differentiated Public Operators for Natural Gas and Electrical Systems
 - New Environment and Industrial Security Regulator

Mexico's Energy Reform

The basic scheme (6)

- Power Sector only in Generation
 - CFE will keep all the infrastructure
 - CFE could hire any private company
 - Private companies can participate in association with CFE
 - Private companies can participate directly only in generation
- The new Public Entity that will Operate the Electrical System will buy from the different producers
 - Rules for the “ market ”
 - Guarantee of Open Access
 - Specific regulations for the use; in terms of competition of the National Grid and the Distribution areas

The future of Oil & Gas

Mexico's Potential

Mexico's Geological Potential



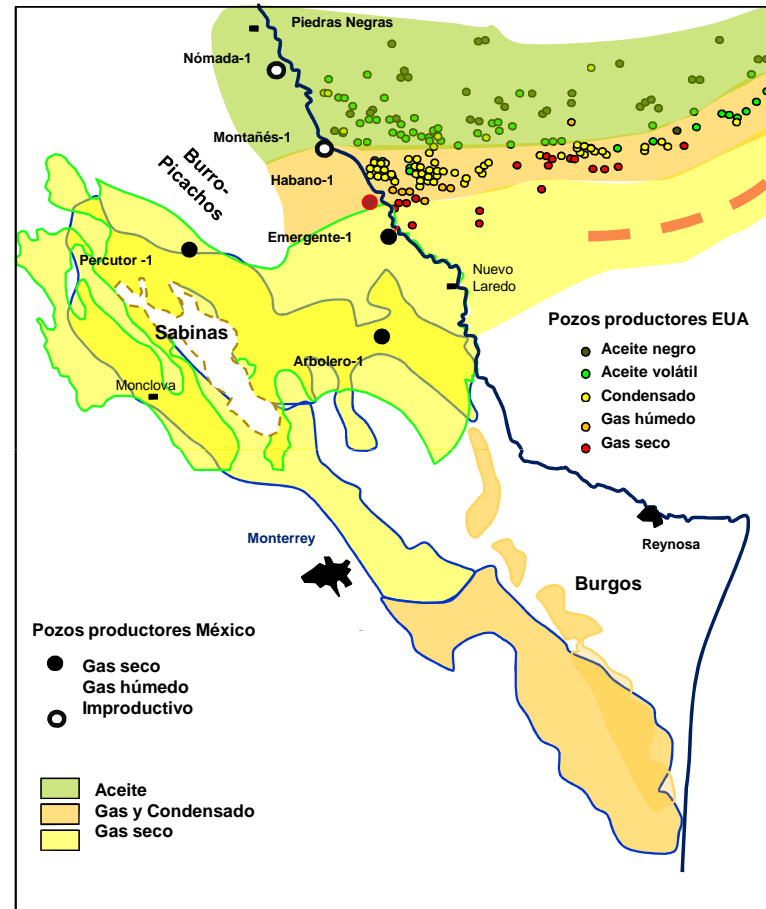
5 geological potential *shale-gas areas* :

Chihuahua
Sabinas-Burro-Picachos
Burgos
Tampico-Misantla
Veracruz

Estimated prospective resources:

200 - 400
Tcf.

Main Potential areas in Northern Mexico



Eagle Ford

Sabinas – Burro - Picachos
& Burgos

Mexico's Energy Reform

Timeline

- The schedule for big changes remains aggressive
 - Round Cero, final call, sept 2014
 - Specific laws and regulation, summer 2014
 - 1 year for the creation of the new regulators (dec 2014)
 - 2 years for the new public companies (dec 2015)
- That means a lot of productive legislative work
- After going thorough Congress, administrative rules coming from the goverment needed (+ - 1 year)
- First results, after Congress elections (june 2015)

Mexico's Energy Reform

Final Comments

- Mexico has a lot of unknown resources
 - Conventional 3 mbod
 - Deep Water 2 mbod
 - Unconventional 2 mbod
- The Reform, is a good first step, but it is only the beginning:
 - Nationalism, there could be a referendum in federal elections next year (jun 201
 - Even with a good legal & regulatory environment, it is going to take a long time for adaptation and deep transformation
- Last big chance for Mexico (Growth, Job creation)

Gracias (thank you)

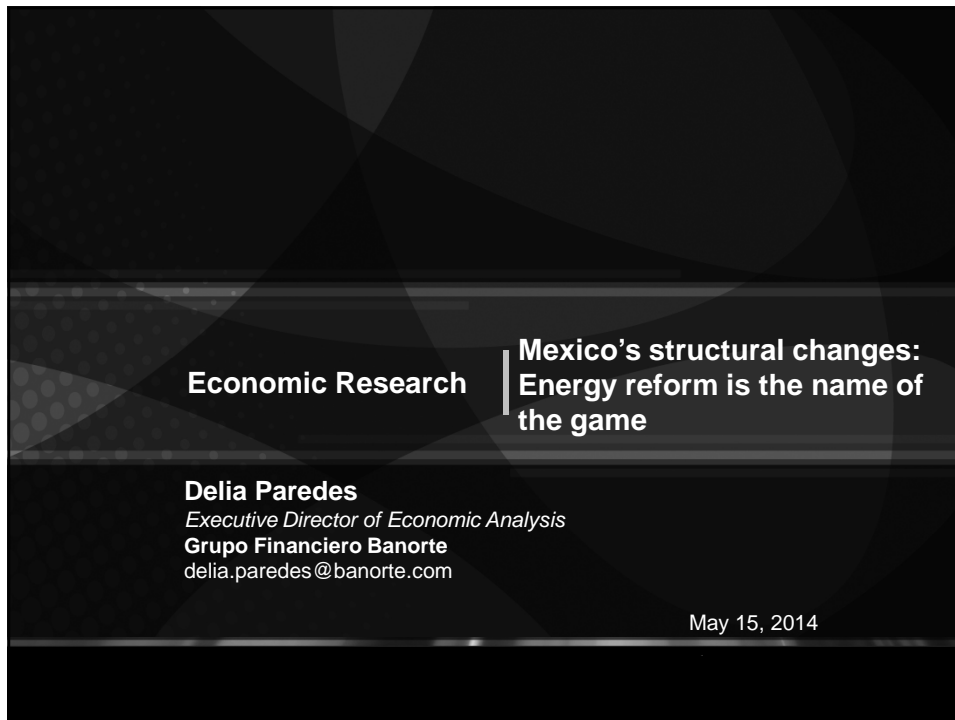
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THANK YOU





Economic Research | **Mexico's structural changes:
Energy reform is the name of
the game**

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May 15, 2014











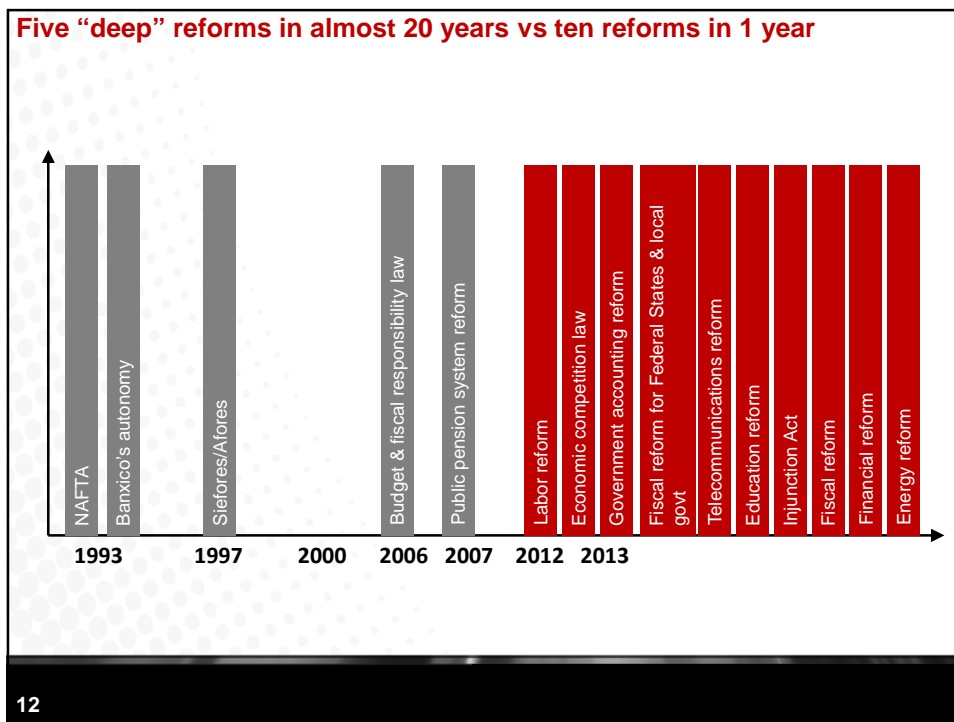
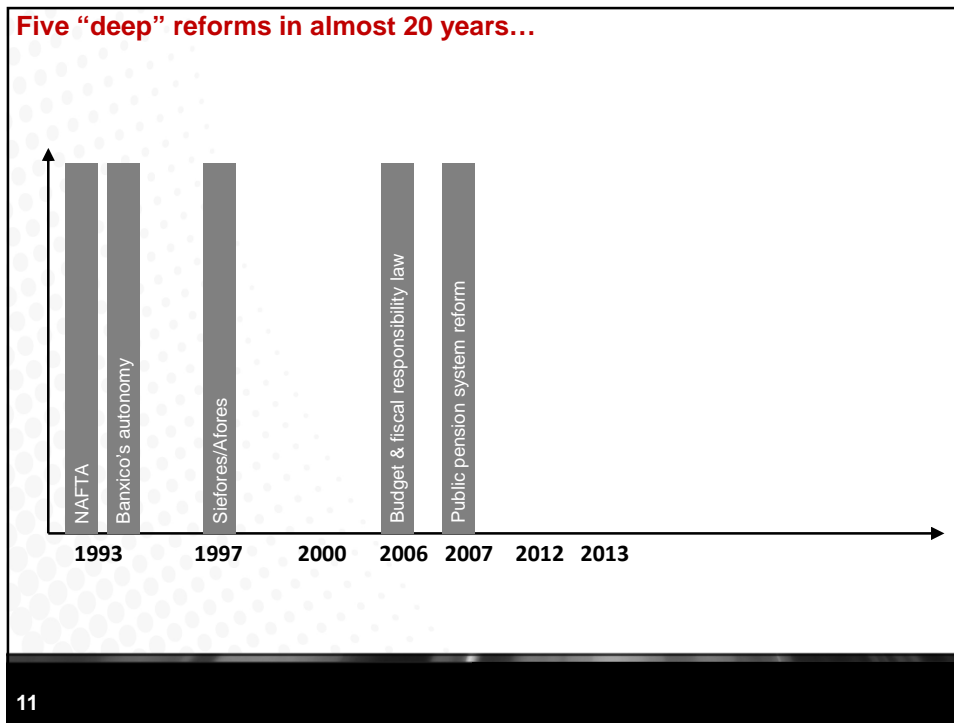
Agenda

Unprecedented structural reform effort

Energy reform

Mexican Oil Fund

When are gasoline prices going to come down?



Structural reform in Mexico could add 2.5% to potential GDP

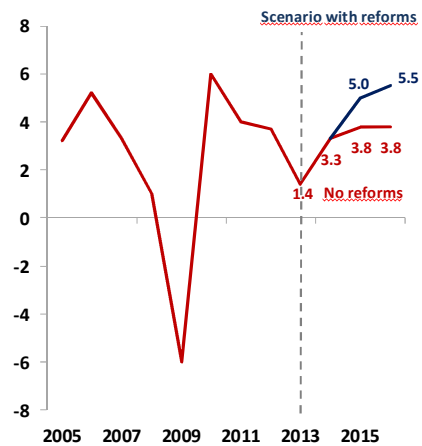
Structural reforms and potential GDP

%, contribution to potential GDP

New potential GDP	5.50
Current potential GDP	3.00
Total (reforms)	2.50
Labor (2012)	0.25
Fiscal (2013)	0.50
Bank lending (2013)	0.75
Energy (2013-2014)	1.00

GDP growth

%yoy



Source: INEGI and Banorte-Ixe.

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Agenda

Unprecedented structural reform effort

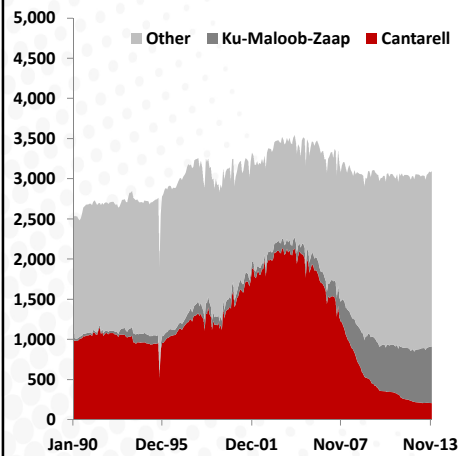
Energy reform

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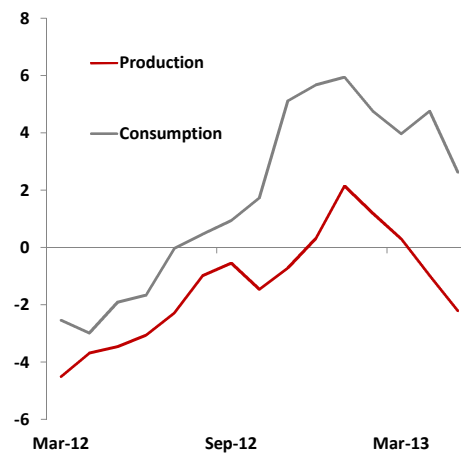
When are gasoline prices going to come down?

Energy reform tries to tackle the decline in crude oil and natural gas production...

Crude oil production
mdb



Output & demand of natural gas in Mexico
mcf

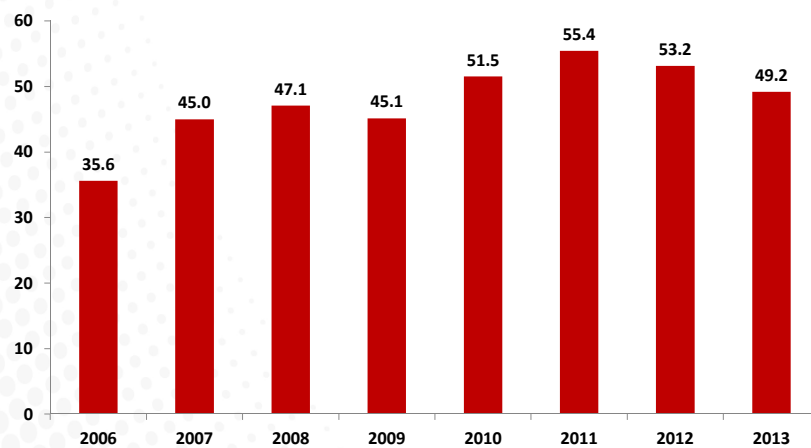


Source: Banorte-Ixe with data from SENER

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...as well as the increase of imported fuels

Consumption of imported gasolines
% of total consumption



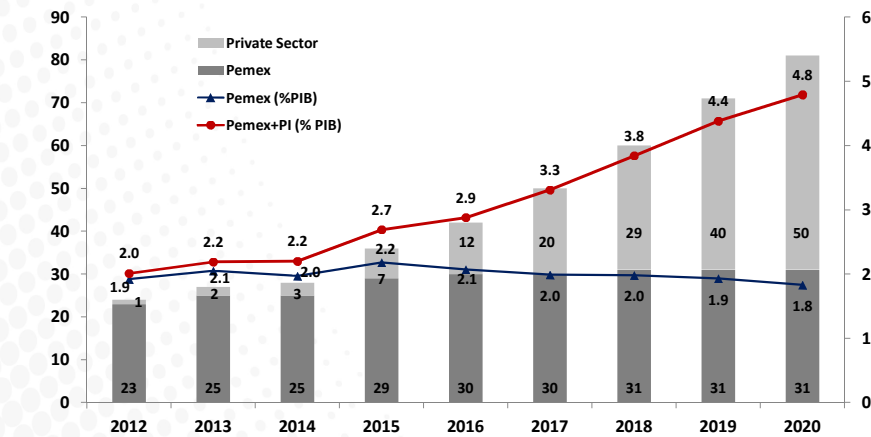
Source: Banorte-Ixe with data from Pemex

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The energy reform opens up a huge pipeline of potential investments...

Capital spending in the energy sector

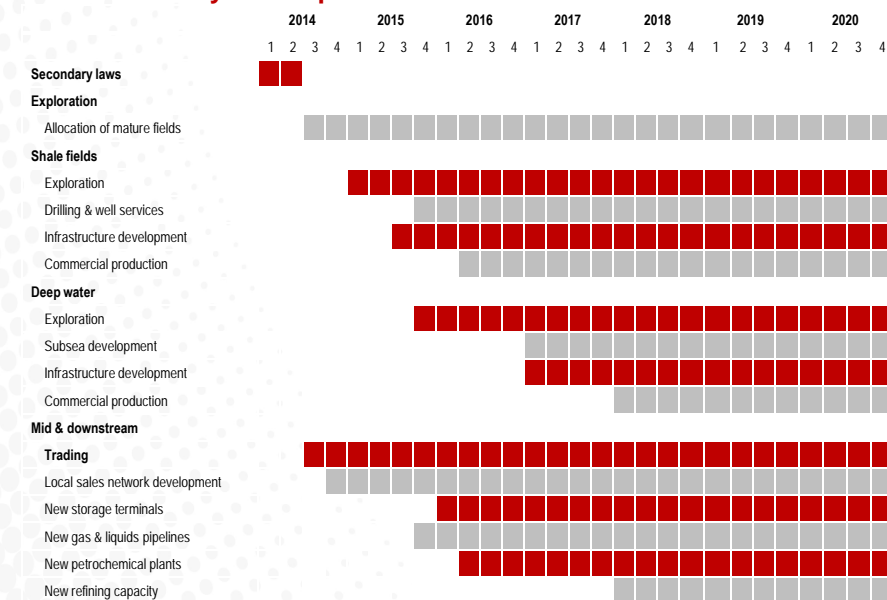
US\$bn



Source: Marcos y Asociados

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...with a relatively fast implementation schedule



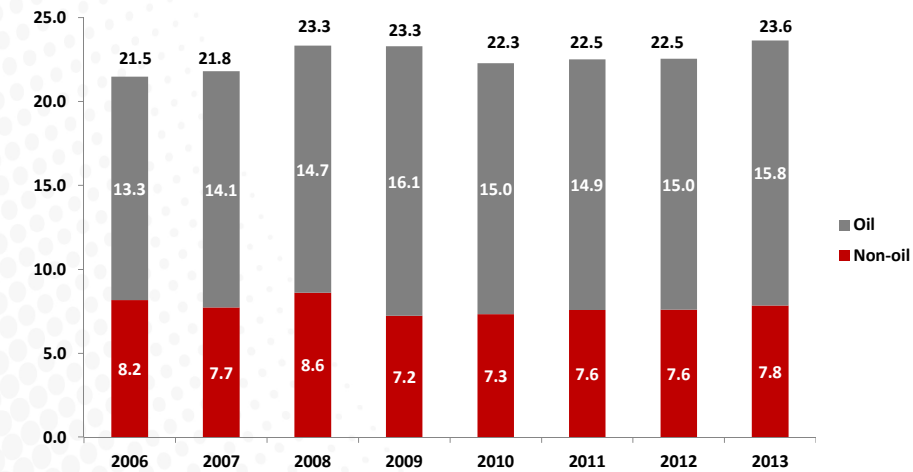
Source: Marcos y Asociados

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In terms of fiscal accounts, the government revenues will remain oil dependent....

Government revenues

% of GDP



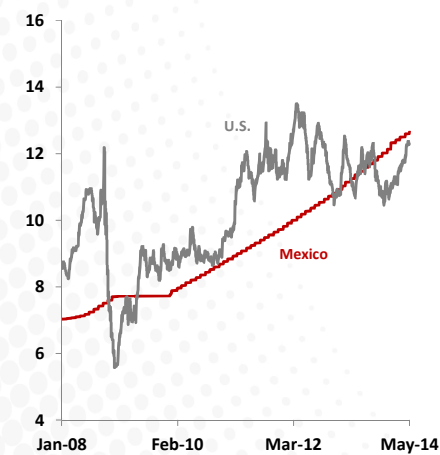
Source: Banorte-Ixe with data from MoF

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...but some of the distortions in fiscal accounts could be reduced

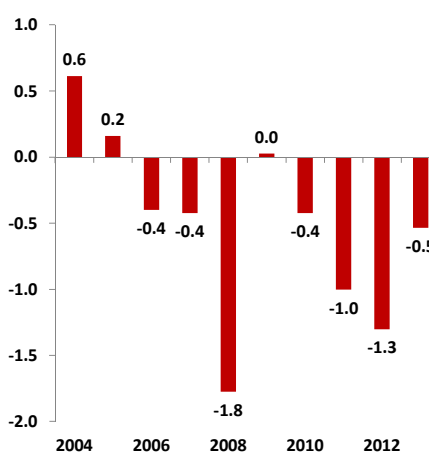
Low-grade gasoline prices

Mexican pesos per liter



Gasoline subsidy

% of GDP



Source: Banorte-Ixe with data from the MoF and Bloomberg

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When are gasoline prices going to come down?

Mexico's Sovereign oil fund

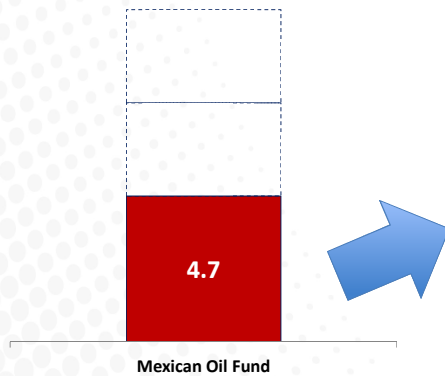


Source: Presidencia de la República

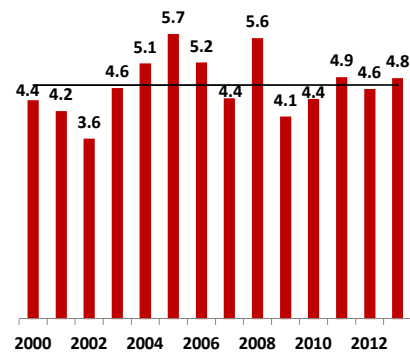
How the Mexican Oil Fund works?

- ① The Fund will transfer the equivalent to 4.7% of GDP to the government every year...

Resources in the Mexican Oil Fund
% of GDP



Current government oil revenues
% of GDP



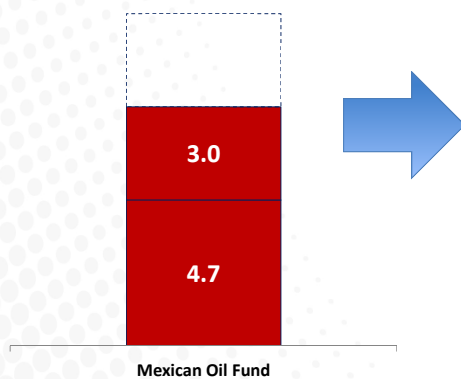
Source: Banorte-Ixe with data from MoF and Presidencia de la República

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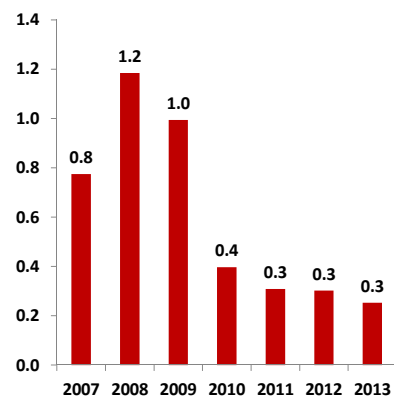
How the Mexican Oil Fund works?

- ② Then it will start saving up to 3% of GDP

Resources in the Mexican Oil Fund
% of GDP



Oil Stabilization Fund
% of GDP



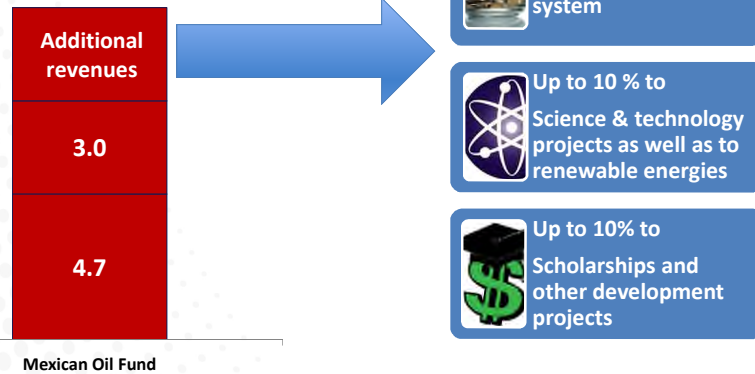
Source: Banorte-Ixe with data from MoF and Presidencia de la República

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How the Mexican Oil Fund works?

③ 60% of any excess over 3% of GDP could be transferred to the government

Resources in the Mexican Oil Fund
% of GDP



Source: Presidencia de la República y Google Images

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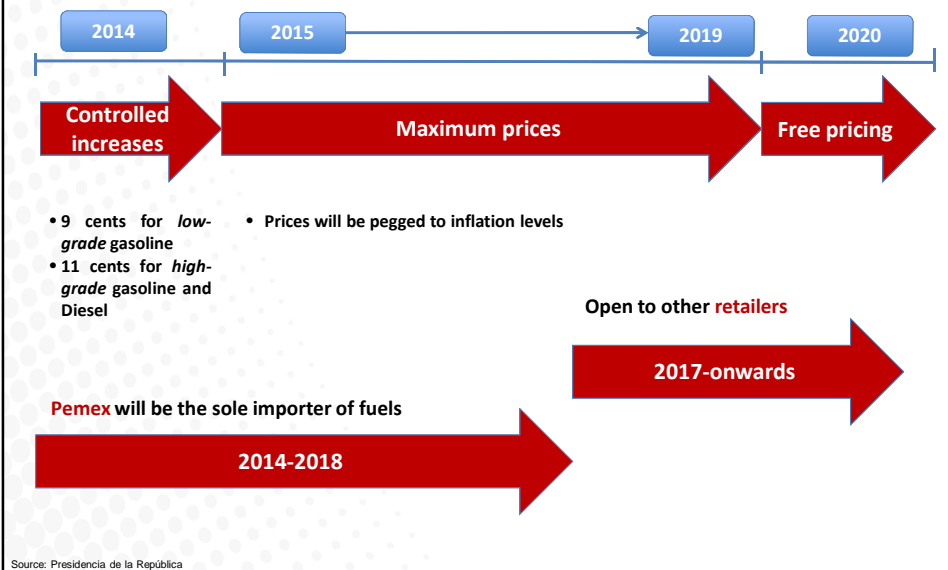
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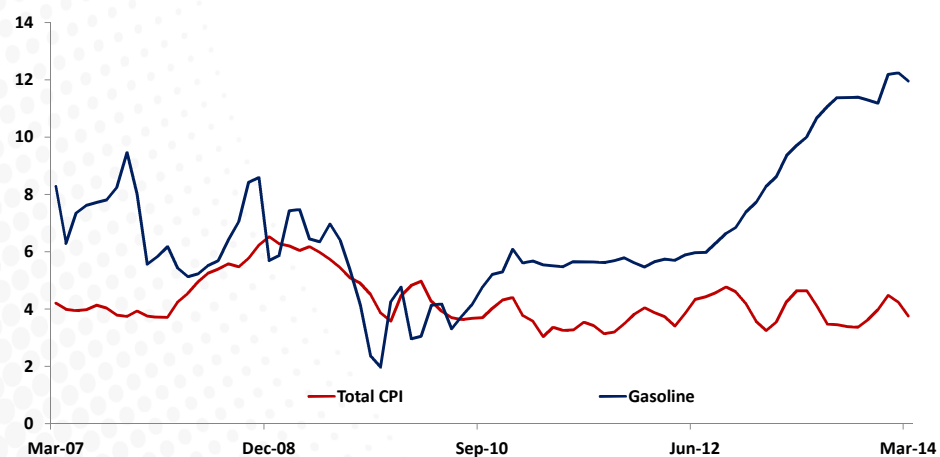


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"Pegging" gasoline prices to CPI should moderate fuel inflation

Consumer price index

%yoy



Source: INEGI

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Thank you!

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