MOODY'S INVESTORS SERVICE

Rating Action: Moody's downgrades PEMEX's ratings to Ba3; outlook remains negative

27 Jul 2021

New York, July 27, 2021 -- 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 Ba3 from Ba2. Moody's also lowered PEMEX's Baseline Credit Assessment (BCA), which reflects its standalone credit strength, to caa3 from caa2. These rating actions were based on PEMEX'S high liquidity risk and increasing business risk as the company faces high debt maturities while it expands its refining capacity and production. Moody's believes that such strategy will generate higher refining operating losses in the short and medium term. The outlook on Pemex's ratings remains negative primarily given the negative outlook on the Mexico government's Baa1 rating.

Ratings downgraded as follows:

Downgrades:

..Issuer: Pemex Project Funding Master Trust

....Senior Unsecured Medium-Term Note Program, Downgraded to (P)Ba3 from (P)Ba2

....Senior Unsecured Regular Bond/Debenture, Downgraded to Ba3 from Ba2

..Issuer: Petroleos Mexicanos

.... Corporate Family Rating, Downgraded to Ba3 from Ba2

....Senior Unsecured Medium-Term Note Program, Downgraded to (P)Ba3 from (P)Ba2

....Senior Unsecured Regular Bond/Debenture, Downgraded to Ba3 from Ba2

Outlook Actions:

..Issuer: Pemex Project Funding Master Trust

....Outlook, Remains Negative

..Issuer: Petroleos Mexicanos

....Outlook, Remains Negative

RATINGS RATIONALE

PEMEX's Ba3 corporate family rating and caa3 BCA reflect Moody's view that the company's liquidity needs and negative free cash flow will rise in the next three years due to high debt maturities and lower operating cash flow derived from the expansion of its refining business, which has generated operating losses in the last several years (close to $17 billion in 2018-20, as reported). Although oil and gas production growth has been below management targets, Moody's acknowledges that PEMEX has been successful in reverting production and reserves declines in the last two years and believes that this trend will continue in 2021. However, Moody's expects that PEMEX's cash flow generation and credit metrics will deteriorate further in the next three years as the company increases fuel production, while grappling with limited capital investment ability, high debt maturities, and volatile oil and fuel prices.

PEMEX's Ba3 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 six notches of uplift from the company's caa3 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. For 2021, the government announced a $3.5 billion reduction in PEMEX's taxes and cash transfers to help the company repay debt maturities of $6.5 billion in the year. Moody's assumes that the government will continue to fund PEMEX's cash needs and help the company comply with its debt amortization obligations of $5.8 billion in 2022 and $6.4 billion in 2023.

PEMEX has weak liquidity and is highly dependent on government support. On March 31, 2021, PEMEX had $2 billion in cash and currently has less than $175 million in available committed revolving credit facilities to address over $10.8 billion in debt maturities from April 2021 to the end of 2022, besides substantial negative free cash flow in the period, driven by insufficient operating cash generation to pay taxes and invest in capital.

The negative rating outlook on PEMEX's Ba3 ratings is primarily based on the negative outlook on Mexico's Baa1 rating given the importance of the sovereign's credit strength and ongoing support to PEMEX's ratings.

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

A downgrade of Mexico's Baa1 rating would likely result in a downgrade of PEMEX's rating. For Moody's to consider an affirmation of PEMEX's Ba3 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 (i) strengthen its liquidity position (ii) internally fund enough capital investment to fully replace reserves and deliver modest production growth and (iii) generate free cash flow for debt reduction. Because PEMEX's ratings are highly dependent on the 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.

Further downgrades in the company's BCA could also lead to further downgrades 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 decline and decreases in reserves life.

An upgrade is unlikely in the near term 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, 2020 the company produced an average of 1,706 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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