Moody's

Rating Action: Moody's affirms PEMEX's B1 ratings; outlook changed to negative

21 Jul 2023

New York, July 21, 2023 -- Moody's Investors Service ("Moody's") affirmed at B1 Petroleos Mexicanos' (PEMEX) corporate family rating (CFR) and the senior unsecured ratings on the company's existing notes, as well as the ratings based on PEMEX's guarantee. Moody's also affirmed PEMEX's Baseline Credit Assessment (BCA), which reflects its standalone credit strength, at caa3. At the same time, Moody's changed the outlook on PEMEX's ratings to negative from stable.

..Issuer: Petroleos Mexicanos

.... Corporate Family Rating, Affirmed B1

.... Baseline Credit Assessment, Affirmed caa3

....Backed Senior Unsecured Medium-Term Note Program, Affirmed (P)B1

....Backed Senior Unsecured Regular Bond/Debenture, Affirmed B1

Affirmations:

..Issuer: Pemex Project Funding Master Trust

....Backed Senior Unsecured Medium-Term Note Program, Affirmed (P)B1

....Backed Senior Unsecured Regular Bond/Debenture, Affirmed B1

Outlook Actions:

..Issuer: Pemex Project Funding Master Trust

....Outlook, Changed To Negative From Stable

..Issuer: Petroleos Mexicanos

....Outlook, Changed To Negative From Stable

RATINGS RATIONALE

The affirmation of the caa3 BCA reflects Moody's expectations that PEMEX will continue registering 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, high interest expenses and high debt maturities in 2023-25. The action also takes into account that PEMEX's access to the capital markets is currently limited given its high intrinsic credit risk and the lack of measures to mitigate its exposure to Environmental, Social and Governance (ESG) risks.

Despite current oil prices that are below the budgeted price, Moody's expects PEMEX's exploration and production (E&P) business to continue supporting the company's cash generation. PEMEX has been able to maintain oil and ga production and reserves at relatively stable levels and achieve production growth through condensates. Given PEMEX's inability to invest larger sums of capital in E&P, Moody's estimates that in 2023 and 2024, the company will only be able to sustain production and reserves at current levels. However, Moody's also recognizes that current oil prices will result in high royalties and operating costs at the refining business.

The caa3 BCA also incorporates PEMEX's weak liquidity and its high dependence on government support. As of March 31, 2023 the company had $3.3 billion in cash and no availability under its committed revolving credit facilities t address debt maturities.

PEMEX's B1 ratings take 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 (Baa2 stable) , resulting in five notches of uplift from the company's caa3 BCA. Since 2016, and most importantly and increasingly from 2019 to 2023, 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 in 2023 and 2024 and help the company to comply with its debt amortizations of $4.6 billion in 2023, $10.9 billion in 2024, and $4.9 billio in 2025, as of March 2023.

The negative outlook on PEMEX's ratings reflects Moody's view that absent fundamental changes in PEMEX's business strategy the company is likely to face increased credit risks, given the inability of the company to increase capital investments and improve its financial and operating performance as a result of liquidity constrains.

Moody's assumes that support coming from the Government of Mexico will continue to be very high in 2023 and 2024. But, as the company's underlying financial fundamentals are likely to continue to deteriorate under a scenario that incorporates no changes to the current business model, Moody's also contemplates that the next administration - which is set to take office in late 2024 - will find it increasingly burdensome to replicate what has been observed in recent years, as prospects of reduced fiscal space in the coming years would restrict the sovereign's ability to provide support at levels comparable to those registered throughout the outgoing Lopez Obrador administration.

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

Although an upgrade is unlikely in the near term, a return to a stable outlook could result from regained confidence in PEMEX's ability to implement a strategy to improve its financial and operating performance in the medium term leading to an improvement in its liquidity position. Additionally, a credible plan towards addressing the ESG challenges would also support a return to stable outlook.

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.

Evidence of decline in medium-term production and reserves, or if operating performance is further eroded per lack of maintenance investments, whether as a result of policies that actively undermine growth or because of policy unpredictability to improve the company's performance, would put downward pressure to the ratings. Increasing negative free cash flow that cause the debt trajectory to shift upward, due to higher negative EBITDA from the downstream business and/or increasing financial costs, could also lead to a downgrade.

The horizon over which these trends might materialize is uncertain. While policy action or inaction could lead Moody's to conclude that these risks will crystallize, a period of 18 months may be needed to assess the credit consequences of the uncertainties.

Because PEMEX's ratings are 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 ratings. A downgrade of Mexico's Baa2 rating would likely result in a downgrade of PEMEX's ratings.

ENVIRONMENTAL, SOCIAL, AND GOVERNANCE CONSIDERATIONS

PEMEX's ESG Credit Impact Score (CIS-5) indicates that the ratings are lower than it would have been if ESG risk exposures did not exist and that the negative impact is more pronounced than for the issuers scored CIS-4.

PEMEX's E-5 Environmental Issuer Profile Score primarily reflects exposure to carbon transition risk. Integrated companies with high exposure to upstream business (exploration and production) will face increasing pressure over time, particularly oil and gas producers, as decarbonization efforts and the global transition towards cleaner energy continues. Additionally, PEMEX faces heightened risks related to waste and pollution given the company's gas flaring and increasing number of accidents that have residual impacts on the environment. Fluid and oil spills can cause significant damage to the environment, and pollution may harm the health of the local population; all of this may lead to clean-up costs, increased expenses related to ongoing monitoring and regulatory compliance, fines, employee and community health concerns, delays in production, and reputational and litigation risk.

The S-5 Social Issuer Profile Score assigned to PEMEX is mainly driven by risks related to health and safety and demographic and societal pressures. PEMEX experienced increased accidents at its operating facilities and infrastructure, resulting in numerous injuries and fatalities of its employees. Growing social awareness, rising political pressure over climate change, and technological progress could accelerate the energy transition, though the pace is currently limited by the lack of widespread availability of alternative clean fuels. In addition, investor pressure could lead to higher capital costs and restricted capital access over time. PEMEX has exposure to responsible production risks, which is higher than most integrated oil and gas companies because of the company's substantial issues with its suppliers regarding timely payment.

PEMEX's G-5 Governance Issuer Profile Score reflects the company's agressive financial policies. Given that PEMEX is 100% owned by the Government of Mexico, it faces significant ownership concentration. PEMEX's board is a 10-person body that approves the company's business plan. The five independent board members were appointed by the current government and ratified by the Senate, while the remaining 5 members are top government officials, including the energy and finance ministers.

Profile

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 March 31, 2023, the company posted $116.8 billion in revenue, $119.1 billion in assets and produced an average of 1,969 millions of barrels per day of crude oil.

The methodologies used in these ratings were Integrated Oil and Gas published in September 2022 and available at https://ratings.moodys.com/rmc-documents/393389, and Government-Related Issuers Methodology published in February 2020 and available at https://ratings.moodys.com/rmc-documents/64864. Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of these methodologies.

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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