STANDARD & POOR'S

RATINGSDIRECT®

May 11, 2009

Research Update:

Petróleos Mexicanos (PEMEX) Outlook Revised To Negative; 'BBB+' Foreign, 'A-' Local Currency Ratings Affirmed

Primary Credit Analyst:
Enrique Gomez Tagle, CFA, Mexico City (52) 55-5081-4407;enrique_gomeztagle@standardandpoors.com

Secondary Credit Analyst:
Jose Coballasi, Mexico City (52)55-5081-4414;jose_coballasi@standardandpoors.com

Table Of Contents

721204 | 301047549

Research Update:

Petróleos Mexicanos (PEMEX) Outlook Revised To Negative; 'BBB+' Foreign, 'A-' Local Currency Ratings Affirmed

Overview

- We revised the outlook on the long-term sovereign credit ratings on the United Mexican States to negative from stable.
- Following this action, we revised the outlook on PEMEX and related entity Pemex Project Funding Master Trust to negative from stable, while affirming the ratings on both.
- We also revised the outlook on Kot Insurance Co. A.G. and the $370.3 million senior secured bonds of Conproca S.A. de C.V. to negative from stable, as related entities.

Rating Action

On May 11, 2009, Standard & Poor's Ratings Services revised its outlook on Petróleos Mexicanos (PEMEX) to negative from stable. At the same time, we affirmed our 'BBB+' foreign currency and 'A-' local currency long-term corporate credit ratings on PEMEX. The outlook revision follows the outlook change on the United Mexican States (BBB+/Negative/A-2) to negative from stable. The 'mxAAA/mxA-1+' national scale ratings and stable outlook on PEMEX are unchanged.

We have also revised the outlook on the $370.3 million senior secured bonds of Conproca S.A. de C.V. to negative from stable. This reflects the revision on its off-taker PEMEX and that payment obligations to Conproca are guaranteed by PEMEX and its subsidiaries, PEMEX Exploration and Production and PEMEX Gas and Basic Petrochemicals.

At the same time, we affirmed the 'A-' long-term financial strength rating on Kot Insurance Co. A.G. while revising the outlook to negative from stable. The rating action on Kot mirrors the action on PEMEX, of which we consider Kot to be a core captive subsidiary.

Rationale

The ratings on Petróleos Mexicanos (PEMEX) reflect significant support from the United Mexican States, the country's large oil and gas reserve base, PEMEX's monopoly status in the large Mexican oil and gas market, and its central role in Mexico's energy sector.

Nevertheless, the local currency rating on PEMEX is two notches below that on Mexico. This reflects PEMEX's highly leveraged financial profile, unfavorable reserve replacement rate compared with that of other investment-grade oil companies, and declining production volume. The company's after-tax financial measures are very weak for the rating category because of large unfunded pension obligations and a substantial share of revenues taken by the government. This has resulted in PEMEX financing most of its capital expenditures with debt during the past several years.

The ratings on PEMEX and Mexico are linked because the Mexican government owns the company; PEMEX has an important role in Mexico's economy; the government depends heavily on oil revenues; and the government exercises considerable oversight of PEMEX, particularly with respect to all fiscal aspects of its management.

PEMEX accounts for about 40% of Mexico's public-sector revenue through taxes and dividends, and petroleum and derivatives account for about 15% of the country's total exports (net of "maquila" imports). We believe that PEMEX's importance as a source of tax revenues and export receipts and as a funding vehicle is a strong economic incentive for Mexico to support the issuer during periods of financial distress.

PEMEX enjoys a satisfactory business position. Mexico's extensive base of proved developed and undeveloped hydrocarbon reserves supports this. As of Jan. 1, 2009, proved reserves were about 14.3 billion barrels of oil equivalent (as determined in accordance with Rule 40[a] of Regulation S-X of the Securities Act of 1933, the reporting standard of the U.S. SEC). Also supporting PEMEX's business position is its constitutionally protected monopoly status in most segments of the large Mexican oil and gas market, including exploration and production (E&P), refining, marketing, and certain petrochemicals. However, declining production, commodity price volatility, and government interference--including the high transfers to the government that keep the company from making appropriate capital expenditures--are primary risks to its business.

Although the company has made important investments in the past six years, government ownership has created a heavy tax burden that has limited investment increases. This has led to a weak reserve replacement ratio, other operating inefficiencies, and after-tax financial measures that compare unfavorably with those of other investment-grade oil and gas issuers. We believe the increase in PEMEX's liabilities has exposed it more to commodity price volatility, which could further weaken its after-tax key financial measures and reduce its liquidity if crude oil prices remain low.

PEMEX's historically strong EBITDA generation reflects its extensive proved reserves, competitive lifting costs, and proximity to the U.S. market. Consequently, the company's upstream operations are profitable in most pricing scenarios, although a high percentage of heavy crude oil in the production mix can exacerbate margin compression when pricing is depressed. Accordingly, for the 12 months ended March 31, 2009, PEMEX's EBITDA was reduced to about Mexican pesos (MXN) 586 billion, reflecting lower oil prices during the past two quarters. As of March 31, 2009, the company posted 12-month ratios for funds from operations (FFO) to total debt, EBITDA interest coverage, and total debt to EBITDA of 8.2%, 7.4x, and 2.0x, respectively. (These ratios consider as debt-like obligations the company's unfunded pension liabilities of about MXN589 billion and asset retirement obligations of MXN42 billion).

PEMEX has posted more reasonable after-tax cash flow figures as a result of the use of a cash flow proxy to determine the taxes levied on its E&P operations, coupled with its ability to credit against other duties the negative indirect taxes arising when gasoline reference prices exceed the price at the pump in Mexico. Nevertheless, we expect that taxes will remain an important burden on the company's finances. Therefore, we anticipate after-tax financial performance to remain weak for the rating, as evidenced by the FFO-to-total debt ratio mentioned above. Without the changes needed to moderate the issuer's unfunded pension liabilities, it is unlikely that PEMEX will improve its key financial ratios significantly.

Liquidity

PEMEX's liquidity is adequate. The company has high cash balances and access to bank financing and domestic and international capital markets. As of March 31, 2009, PEMEX had cash and cash equivalents of about $10.1 billion, comparing favorably with short-term debt of $5.6 billion. Despite being free operating cash flow positive in 2006 and 2007, the company more consistently registers negative free operating cash flow because its capital expenditures are higher than its FFO--a figure that is significantly depleted by the high amount taken by the government. This, added to the recent weakening of oil prices, leads us to believe that PEMEX will continue to require external financing to support its investment program. If necessary, PEMEX's oil and gas reserve life of about 9.9 years provides it with flexibility to briefly defer investment in exploration during periods of depressed pricing without immediately affecting production.

The company has received approval from the government to fund some of its capital expenditures with cash on hand. This could mean using a significant portion of its cash balance, which PEMEX should be able to offset by extending the maturities of its debt.

Outlook

The negative outlook on PEMEX's ratings reflects our outlook on Mexico. We do not expect PEMEX's relationship with the government to change significantly in the next two to three years, or the government's heavy involvement in the sector or the company to reduce significantly.

Any improvement would require a combination of the government contributing sufficient capital to allow significant deleveraging; the government sharply reducing PEMEX's tax burden, so that the company could internally fund the bulk of its capital expenditures for maintenance and expansion; PEMEX improving its operations, particularly in reserve replacement; and a reduction in the company's growing unfunded pension liabilities. We could lower the local currency rating if PEMEX's leverage continues to climb significantly, pension liabilities grow disproportionately, and the company's reserve replacement trends do not improve.

Related Research

"Research Update: United Mexican States Outlook Revised To Negative From Stable; Ratings Affirmed," published May 11, 2009

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Petroleos Mexicanos (PEMEX)		
Corporate Credit Rating		
Foreign Currency	BBB+/Negative/--	BBB+/Stable/--
Local Currency	A-/Negative/--	A-/Stable/--
Senior Unsecured	BBB+	BBB+
Kot Insurance Company A.G.		
Counterparty Credit Rating		
Local Currency	A-/Negative/--	A-/Stable/--
Financial Strength Rating		
Local Currency	A-/Negative/--	A-/Stable/--
Pemex Project Funding Master Trust		
Corporate Credit Rating		
Foreign Currency	BBB+/Negative/--	BBB+/Stable/--
Conproca S.A. de C.V.		
Senior Secured		
Foreign Currency	BBB+/Negative	BBB+/Stable

Ratings Affirmed

Pemex Project Funding Master Trust	
Senior Unsecured	BBB+
RepConLux S.A.	
Senior Unsecured	BBB+

Standard & Poor's will hold a teleconference on Tuesday, May 12, 2009, at 10:30 a.m. EDT to discuss this rating action. Callers from Mexico should dial 001-866-839-3438, and the number for participants from everywhere else is (1) 210-234-6980. The Conference ID is 3745813, and the passcode is SANDP.

Complete ratings information is available to RatingsDirect subscribers at www.ratingsdirect.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com; select your preferred country or region, then Ratings in the left navigation bar, followed by Find a Rating.