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April 25, 2012

Summary:
Petroleos Mexicanos

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Summary:

Petroleos Mexicanos

	Local Currency	Foreign Currency
Credit Rating:	A-/Stable/--	BBB/Stable/--

Rationale

The ratings on Petroleos Mexicanos (PEMEX) reflect Standard & Poor's Ratings Services' opinion that there is an almost certain likelihood that the Mexican government would provide timely and sufficient extraordinary support to PEMEX in the event of financial distress. The foreign-currency credit rating on PEMEX is one notch above the company's stand-alone credit profile.

In accordance with our criteria for government-related entities, we base our view of an almost certain likelihood of extraordinary government support on our assessment of PEMEX's "critical" role as the only exploration and production (E&P) company operating in Mexico, its provision of about 40% of Mexico's public-sector revenue through taxes and duties, and its "integral" link with the government, given its full and stable ownership of the company and given that the government drives PEMEX's strategy, determines its key budgetary decisions, and maintains a tight degree of control.

The ratings on PEMEX also reflect Mexico'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. PEMEX's significant financial risk profile and improving reserve replacement rate, although lower than other investment-grade oil companies, offset the positive factors. The company's after-tax financial measures reflect the weight of a substantial share of revenues taken by the government and its large unfunded pension obligations. This has resulted in PEMEX financing about 40% of its capital expenditures with debt during the past several years.

PEMEX has launched its first tender of integrated E&P contracts for three mature fields in the Southern Region: Santuario, and Magallanes awarded to Petrofac Facilities Management (not rated); and Carrizo to Dowell Schlumberger de México S.A. de C.V. (not rated). We believe that this type of contract should allow PEMEX to operate more efficiently and, therefore, to increase its production levels. We expect it to award the second tender of contracts in June 2012.

The company's credit quality benefits from Mexico's extensive, proven developed and undeveloped reserve base of about 13.8 billion barrels of crude oil equivalent for 1P hydrocarbons reserves, that allows for approximately 10 years of production. Given the company's intensive capital expenditure program, its integrated proved Reserve Replace Rate (RRR) improved to 101.1% as of January 2012 from 85.8% a year ago. We believe that PEMEX will be able to increase its RRR further in the following years as a result of its capital-expenditure program and the new incentive-based contracts.

In 2011, PEMEX's average daily crude oil production was 2.550 million barrels per day (Mbd) and 6.594 billion cubic feet per day of natural gas; reaching a production of 3.72 million barrels of oil equivalent per day. The company has been able to stabilize production at about 2.5-2.6 mbpd figure. Although, the production from its Cantarell field continues to decline, we expect PEMEX to continue to be able to offset this with increased output in other fields, mainly Ku-Mallob-Zaap, Crudo Ligero Marino, Ixtal-Manik, and Delta Grijalva.

PEMEX's financial performance continues to improve as a result of higher oil prices in recent years. During 2011, PEMEX posted EBITDA interest coverage of 6.9x, funds from operations (FFO) to total debt at 9.1%, and total debt to EBITDA of 1.9x, compared with 5.1x, 7.2%, and 2.0x, respectively, for the same period in 2010. These ratios consider the company's unfunded pension liabilities and asset retirement obligations of about $60.6 billion (as debt-like obligations). We expect that taxes will remain an important burden on the company's finances. Therefore, we expect after-tax financial performance to remain weak for the rating, with an FFO to total debt ratio of less than 10%.

Liquidity

PEMEX's liquidity is adequate. We believe that PEMEX's resources will be sufficient to cover its needs for the foreseeable future, even assuming significant declines in EBITDA. We expect the company's cash sources (including cash, FFO, and credit line availability) during the next 12-18 months to exceed uses by 1.67x. As of Dec. 31, 2011, the company held cash and short-term investments of $8.4 billion and $3.5 billion available under its committed credit lines, which compares favorably with $7.9 billion in short-term debt maturities.

The company's ample access to bank financing and to domestic and international capital markets also supports its adequate liquidity. We expect PEMEX to continue tapping local and international markets throughout 2012. As of March 31, 2012, PEMEX had US$2 billion and Swiss franc (CHF) $300 million in debt in international markets. To continue diversifying its portfolio, PEMEX raised Australian dollar (A$)150 million in the Australian market recently.

We believe that PEMEX will continue to require external financing to support its investment program of about $24 billion during 2012, mainly for exploration and production. PEMEX's free operating cash flow remained negative at $3.9 billion in 2011, although it is improving. The company does not have any financial covenants.

Outlook

The stable outlook on PEMEX reflects our outlook on Mexico and our expectation that PEMEX's relationship with the government won't change significantly in the next two to three years. It also reflects our belief that the government won't significantly reduce its heavy involvement in the sector or in the company. Given our assessment of an almost certain likelihood of support from the government, upward or downward rating movements would most likely follow the Sovereign's rating trajectory.

Related Criteria And Research

- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010
- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, May 27, 2009
- 2008 Corporate Criteria: Analytical Methodology, April 15, 2008