EMERSON LETTER™

June 10, 2019

Pemex – Is the Well Running Dry?

Global oil prices are down 20% from their recent geopolitical risk rally high, oil production in Mexico continues its decline, and the cost of funding for Pemex is on the rise. All of these trends paint a dire picture for Pemex, and ultimately Mexico's government finances.

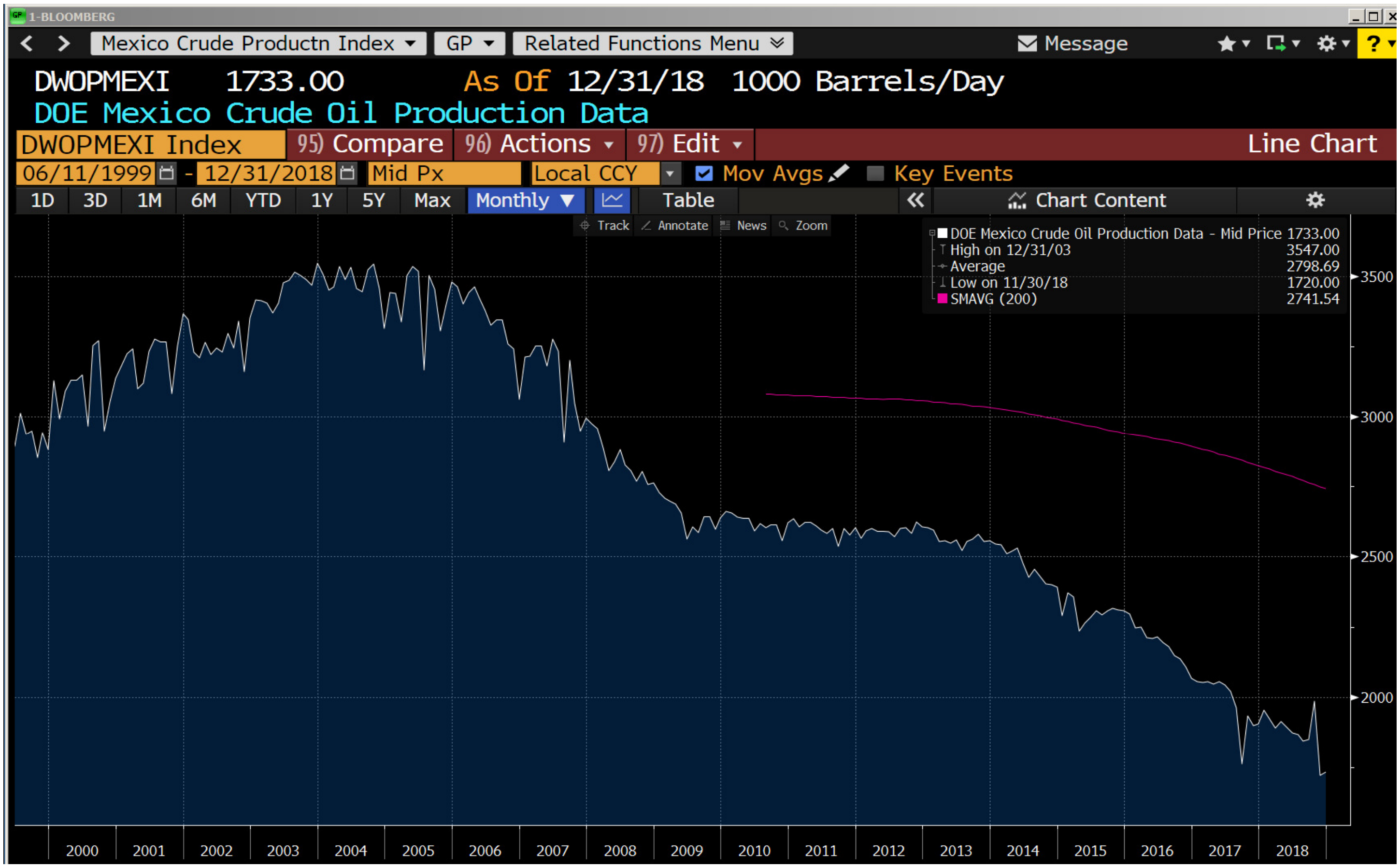
In a recent report, Morgan Stanley analysts referred to oil as the new aluminum. They suggest that deflationary forces are gathering momentum, and that the medium-term outlook for oil prices is to trend lower. They site potential shale growth of > 1 mb/d per year all the way out to 2025, and with break evens in the $40-45/bbl. range, this US region will continue to attract larger amounts of global oil capex supporting this growth. In addition, they state that in order to remain competitive, sovereign taxes on national oil companies will have to decline. This will further lower the cost curve around the globe, which will increase supply.

Recent downgrades by both Moody's and Fitch place debt of Pemex in a very precarious position. With ratings now just a hair above junk bond status, financing costs are increasing and the potential liquidation of debt positions by investment grade only holders is a risk. At $106.50 billion, Pemex is one of the most debt laden companies in the world. Total proved reserves of 6.8 barrels of oil equivalent(boe) at December 31, 2018, represent a reserve life of just 7.7 years. Stable to higher oil prices might allow Pemex to muddle along, but if oil prices fall back to late 2018 or even early 2016 lows, the finances of Pemex will be heavily strained. How will Pemex stabilize or increase oil production from current levels to match growth as we have seen in Russia and the Permian basin, instead of following the path of Venezuela?

Respectfully,

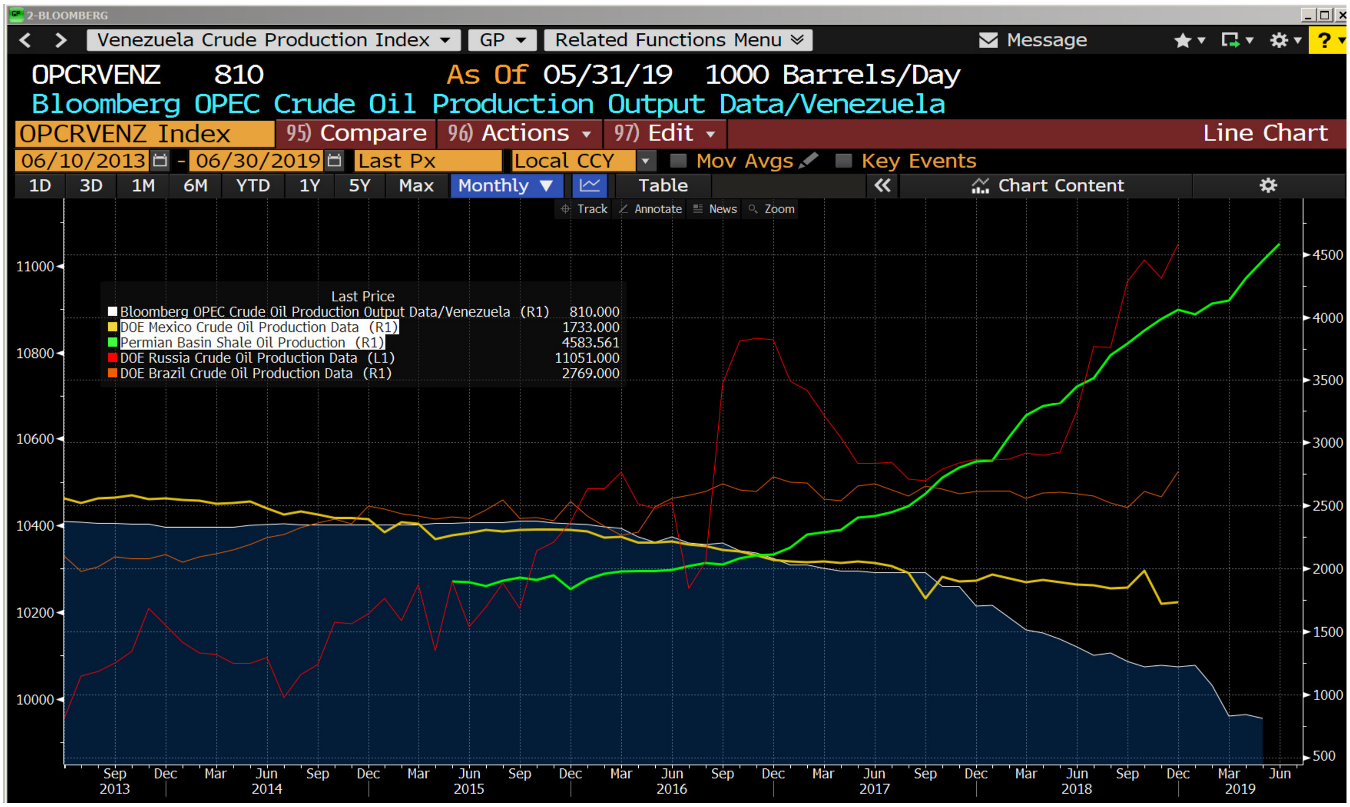
Emerson Letter Editor

Mexico Crude Oil Production continues to drop:



Source: Bloomberg

Will Mexico's oil production continue to fall as we have seen in Venezuela, or will we see an upturn and future production will follow the trends of Brazil, Russia and the Permian Basin?

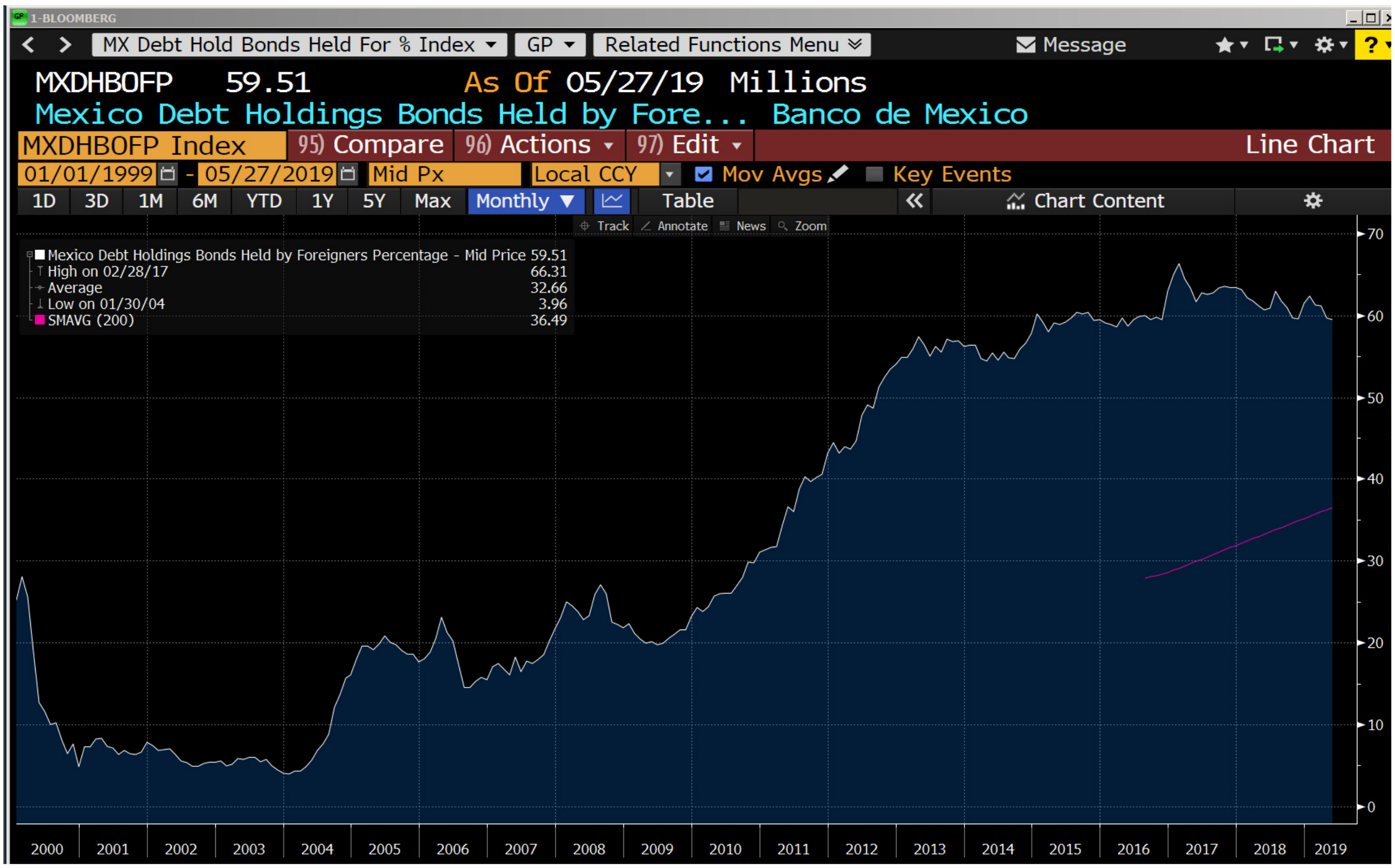


Source: Bloomberg

Pemex 6 5/9% Perpetual debt has been hammered by investors:

Source: Bloomberg

Foreigners own historically high percentage of Mexican Local Currency Debt at approximately 60% of total debt outstanding. Who will buy this debt as finances become ever strained, and what will this do to the Mexican Peso?



Source: Bloomberg

As a result of strained Pemex finances, are we going to see another Mexican Peso crisis?

Source: Bloomberg

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