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THE FEDERAL GOVERNMENT ANNOUNCES THE SUPPORT STRATEGY FOR PETRÓLEOS MEXICANOS

- ***The Federal Government announced measures to strengthen the financial position of Petróleos Mexicanos (Pemex):***
  1. ***An equity contribution to Pemex of Ps. 26.5 billion will be made on April 15th, making use of the Federal Government's budgetary leeway that resulted from the preemptive adjustment announced on February 17th, 2016.***
  2. ***A liquidity provision amounting to Ps. 47 billion will be granted to Pemex in order to cover pension and retirement payments during 2016. This will be through the exchange of part of the provisional notes granted to Pemex in 2015, for Federal Government securities.***
- ***This support from the Federal Government will provide the company with liquidity for Ps. 73.5 billion.***
- ***In order to obtain this support, Pemex must commit to reduce its current liabilities by the same amount, and restrict the remaining current liabilities to obligations contracted in 2016. Also, Pemex must implement mechanisms to adequately register and manage these liabilities.***
- ***Additionally, there will be changes to the fiscal regime applicable to the assignments operated by Pemex, in order to better reflect the operating conditions of the company. The adjustment will contribute to the strengthening of the company's balance.***
- ***The reduction of Pemex's current liabilities will be reflected in higher spending and, thus, a deterioration of the Public Sector Borrowing Requirements (PSBR). However, considering the effect of the receipt of the Central Bank's operating surplus for Ps. 239 billion, announced on April 11th, it is estimated that Public Sector Borrowing Requirements(PSBR) and the Historical Balance of the Public Sector Borrowing Requirements (PSBR) will improve in 2016.***
- ***In addition, Pemex will maintain its previously announced spending adjustment plan for Ps.100 billion.***

Petróleos Mexicanos (Pemex) has historically been a fundamental institution for the Mexican economy and its public finances. Nevertheless, the adverse economic conditions in the global hydrocarbons sector, in conjunction with the depletion of several oil fields, has weakened the financial situation of Pemex. In this context, the Federal Government has worked with the company to define the most convenient mechanisms to support and strengthen the financial position of Pemex.

In the current context of low oil prices, the Federal Government will support Pemex using several instruments, which will result in improved operational results, a capitalization of the company and an immediate increase in liquidity. Furthermore, this support will contribute to align the incentives within the company, so that improvements in management become the main axis of Pemex's strengthening.

The Federal Government will provide support equivalent to Ps. 73.5 billion through the following instruments:

I. An equity contribution from the Federal Government of Ps. 26.5 billion using the Federal Government's budgetary leeway created by the preemptive adjustment announced on February 17th of this year.
II. An exchange, during the year, of part of the provisional Ps. 50 billion note that the Federal Government granted Pemex in 2015 by ministry of law (as part of the Federal Government's take-over of Pemex's pension liabilities).[1] Through this operation, Pemex will receive Ps. 47 billion worth of tradable securities from the Federal Government, which will be used for the payment of pensions and retirements during 2016.

The support from the Federal Government is contingent on Pemex reducing its current liabilities, as well as its debt to suppliers and contractors, by the same amount. That is, Ps. 73.5 billion. Also, Pemex will commit to limiting this year's remaining current liabilities

[1] As part of the Energy Reform, the third transitory article of the reform to LFPRH of 2014 indicates that the Federal Government may assume a share of the obligation to pay pensions and retirements in payment process, as well as those corresponding to Pemex active workers and its subsidiaries, as long as the company reaches an agreement to modify the collective bargaining agreement that in the medium term leads to a reduction in pension and retirement obligations for Pemex.

to obligations generated during 2016, and to establish mechanisms to register and properly manage these obligations, ensuring sustainable debt levels.

The equity contribution will have a positive impact on the budgetary balance of the company, since it will be recorded as an income. However, it will have no impact on the Public Sector's balance, as it is a compensated transaction.

The cancellation of Pemex's current liabilities will be reflected as higher spending and result in a deterioration of Public Sector Borrowing Requirements (PSBR). However, as described below, the adjustment to Pemex's fiscal regime will be reflected in an overall better financial position for the company.

The Federal Government's support also includes changing Pemex's fiscal regime. It will now allow Pemex to make further costs deductions when the company acquires onshore and shallow-water exploration and extraction assignments.[2] Specifically, the fiscal regime changes establish deduction limits to determine the profit-sharing duties for shallow-waters and onshore fields of at least 6.10 and 8.30 dollars per barrel of oil equivalent, respectively. Should the Hydrocarbons Law cost-deduction cap be greater than the previously mentioned values, Pemex may choose to apply this limit.

Oil prices and production costs usually move in the same direction and by similar magnitudes as a result of market shocks. It is for this reason that the Hydrocarbons Revenues Law established cost-deductions caps that would be equivalent to a share of the production value. However, despite recent drops in extraction costs as a result of the deterioration in the international oil market over the past few months, cost declines have been proportionally smaller than the sharp drop in hydrocarbons prices.

It is worth noting that, as opposed to the fiscal regime that was in place before the Energy Reform, Pemex's current fiscal regime allows the company to transfer non-deducted costs to subsequent years, and then enables the company to eventually deduct all of its costs. However, low oil prices have constrained deductions, thus generating short-term liquidity pressures for the company. Therefore, the proposed adjustment for the Pemex fiscal regime takes into account that costs have not adjusted downwards at the same rate as prices have, contributing to increase the company's liquidity.

[2] The amendment to the tax regime will apply to the activities of the holders of assignations for exploration and extraction of hydrocarbons. Currently, Pemex is the only Assignee.

Under current production and price conditions, the changes to the fiscal regime imply a reduction of duties of around Ps. 50 billion from Pemex during 2016. An improvement of an equivalent amount will be reflected on the company's financial balance. Accordingly, this strengthening would increase Mexico's patrimony, and will not deteriorate the Public Sector's financial position.

Taking into consideration the joint effect of the support measures announced for Pemex, and the receipt of the Central Bank's operating surplus, it is estimated that the Public Sector Borrowing Requirements (PSBR) and the Historical Balance of the Public Sector Borrowing Requirements (HBPSBR) will show a net improvement with respect to the originally approved targets for the 2016 fiscal year.

Meanwhile, Pemex will maintain the previously announced spending adjustment approved by its Board of Directors, which is required for the company to be able to face the loss of liquidity generated by the decrease in the international price of hydrocarbons.

These responsible actions taken by the Federal Government with respect to public finances, combined with the strengthening of Pemex's financial position, will enhance macroeconomic stability and foster Mexico's economic activity.

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