Round 2.1 – Excellent result. More than 65% fields allocated

June 19, 2017

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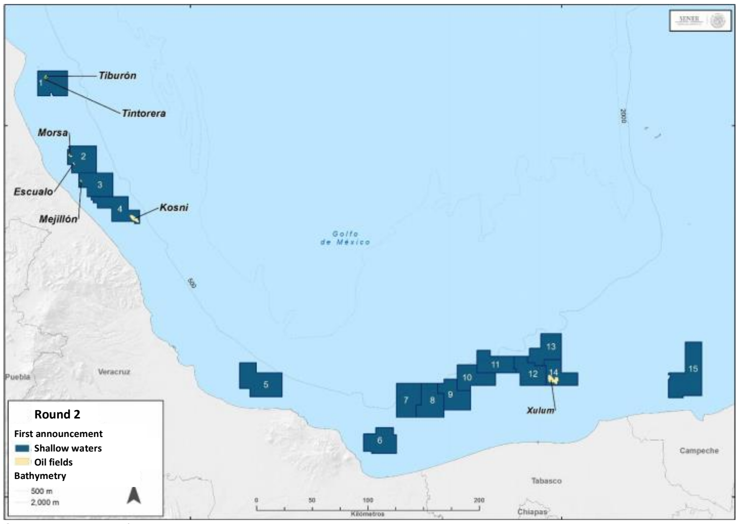
- **The *National Hydrocarbon Commission* (CNH) announced the winners of Round 2.1**
- **10 out of the 15 shallow water blocks tendered were allocated, significantly above government´s expectation (~60%)**
- **In our opinion, the fields tendered in the Southeastern Basin were more attractive than those in the Tampico-Misantla region**
- **It is worth noting that we evaluate this bidding process as "excellent" given two factors:**
  (1) The market has become more skeptical regarding higher crude oil prices amid a complex supply and demand rebalancing scenario; and
  (2) Some market participants have shown concern regarding the possibility that a new federal government might revoke the energy reform
- **In this sense, the positive outcome shows investors' confidence in the institutional strength of the country**
- **The second and third allotment of projects under Round 2 will take place in July 12, 2017**

Round 2.1. The *National Hydrocarbon Commission* (CNH) announced the winners of the first tender under the so-called Round 2 (a.k.a. Round 2.1). We highlight that this round represents the fifth effort by the government to allow private-sector investments into full-blown oil-related projects. Twenty bidders came forth, from which all 20 took part in the final process and 10 won a contract. This package of projects included 15 production blocks in shallow water fields, which covered a total area of 8,908.2 km² (3,439.5 sq. miles). Four are located in the shores of Veracruz in an area known as "Tampico-Misantla". The other eleven areas are located in the southern part of the gulf, in the coasts of Veracruz, Tabasco and Campeche, area known as "*Southeastern Basin*" (as shown in the map below). According to the Ministry of Energy, these zones mainly contain hydrocarbons such as dry gas and light oil.

Blocks tendered in Round 1.4



Source: Ministry of Energy

Excellent allocation. Ten blocks (66%) out of the 15 tendered were allocated, with most of the firms being European, as shown in the table below. This number was above to what the government was expecting (~60%), which continues to suggest interest from multinational oil companies to further develop the Mexican oil industry. It is worth noting that we evaluate this bidding process as "excellent" given two factors: (1) The market has become more skeptical regarding higher crude oil prices amid a complex supply and demand rebalancing scenario; and (2) some market participants have shown concern regarding the possibility that a new federal government might revoke the energy reform. In this sense, the positive outcome shows investors' confidence in the institutional strength of the country

Allocations of Round 2.1

Area	Bidder	Country of Origin	Government's profit margin (%)	Additional investment factor	Weighted value of the economic proposal	Type of hydrocarbon to exploit
1. Tampico-Misantla	Deserted					Light oil and dry gas
2. Tampico-Misantla	Dea Deutsche Erodel and Pemex	Germany and Mexico	57.92	1.0	63.493	Light oil and dry gas
3. Tampico-Misantla	Deserted					Light oil and dry gas
4. Tampico-Misantla	Deserted					Light oil and dry gas
5. Southeastern Basin	Deserted					Wet gas
6. Southeastern Basin	PC Carigali and EcoPetrol Global Energy	Malaysia and Colombia	65.19	1.0	71.178	Light oil
7. Southeastern Basin	Eni, Capricorn Energy and Citla Energy E&P	Italy, United Kingdom and Mexico	75.00	1.5	84.825	Light oil
8. Southeastern Basin	Pemex and EcoPetrol Global Energy	Mexico and Colombia	20.10	0.0	20.100	Light oil
9. Southeastern Basin	Capricorn Energy and Citla Energy E&P	United Kingdom and Mexico	75.00	1.5	84.825	Light oil
10. Southeastern Basin	Eni	Italy	75.00	1.5	84.825	Light oil
11. Southeastern Basin	Repsol Mexico and Sierra Perote E&P	Spain and Mexico	62.28	0.0	62.280	Light oil
12. Southeastern Basin	Lukoil International	Russia	75.00	1.0	81.550	Heavy oil
13. Southeastern Basin	Deserted					Heavy oil
14. Southeastern Basin	Eni Mexico and Citla Energy E&P	Italy and Mexico	37.27	0	37.270	Heavy oil
15. Southeastern Basin	Total E&P and Shell Exploration and Extraction	France and Netherlands	30.11	0	30.110	Wet gas

Source: SENER, CNH

Rounds 2.2 and 2.3 will take place in July 2017. The allocation of both Round 2.2 and Round 2.3 will take place on July 12, 2017. Round 2.2 will involve 12 onshore fields in the states of Tamaulipas and Chiapas. Finally, the final round includes 14 onshore fields in Tamaulipas and Chiapas. Furthermore, 3 associations with Pemex will be allocated on October 4.

From our fixed income and FX strategy team

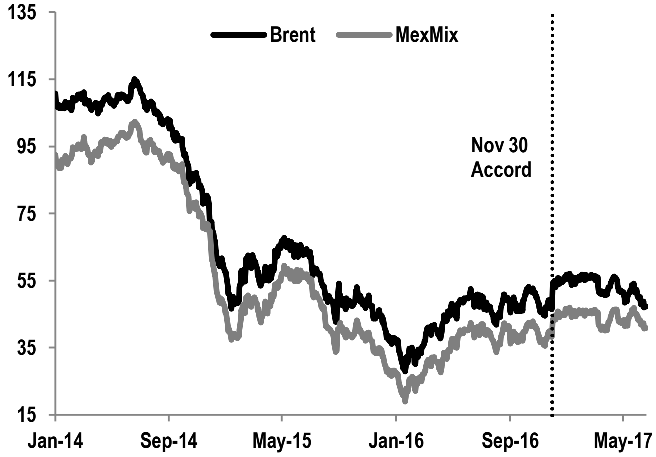
Globally the market has become more skeptical amid a complex supply and demand rebalancing scenario. During the first half of this year, crude oil prices have been influenced by the expectation around a more balanced market mainly derived from the effect of the supply accord reached by OPEC and other producers at the end of last year. However, reality has imposed to the latter effort and has even forced this pact to be extended in duration, just last month. (See: *OPEC & non-OPEC pact: 9 more months*, <pdf>, published on May 26th, 2017). In this sense, main benchmark crudes have been trading within in a relatively narrow range, without reaching the 60 $/bbl area, in the case of Brent.

In fact, up-to-date price action locates trading levels below the ones registered following de agreement's announcement (see chart below on the left), and more recently these have witnessed further deterioration given prevailing U.S. production recovery and still high inventory levels in a context where stronger global demand prints have not surged as a noteworthy evidence. Currently, Brent trades at 47 $/bbl, 17% weaker when compared to last year's close and 15% below the mark prior the supply pact extension announcement. In this sense, it is of great importance to consider the influence that the technical position has had to recent trading, as flows exaggerate price movements and add high volatility sessions.

It is under this scenario that the supply pact agreement has basically build up a floor for prices, after the sharp drop registered in 2014, but have also provide oxygen to greater-cost producers and as a consequence have generated great uncertainty around near-term future price levels. Although global inventory levels are depicting a clear decline path (see chart below on the right), it is very unlikely that these reach one of the expressed targets within the supply pact (the 5-year average), adding as a factor to bearish concerns. In our view, the case for Brent to close higher than 50 $/bbl is still present but we recognize that the bias converges towards the lower-end of this area, reason while we forecast 53-55 $/bbl for December. In this sense, Mexican oil output has seen some decent stabilization during the last months locating at the end of April a 2,012 Mbbl/d level, 7.6% less than a year ago and 41.8% below its 3,455 Mbbl/d historical maximum reached in December 2003. We consider that this type of rounds will support greater local production normalization in the medium-term, especially due to greater expected investment for shallow water projects, in line with recent statements from the International Energy Agency (IEA).

Brent and MexMix performance

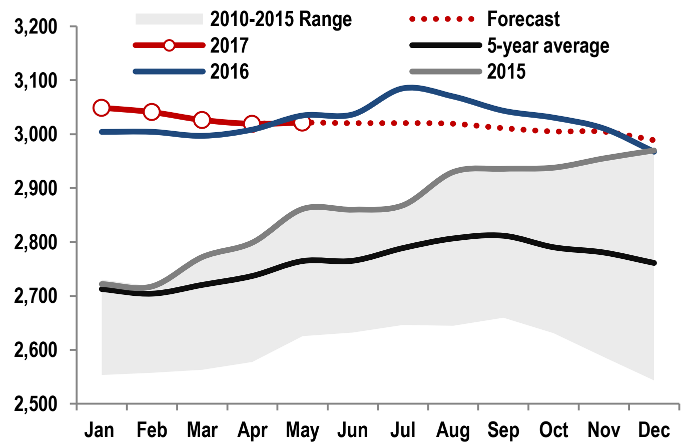
$/bbl



Source: Bloomberg

OECD Commercial Inventory

Mbbl



Source: Banorte-Ixe with data from EIA

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