

Oil bidding process 1.3 – Perfect result

- The *National Hydrocarbon Commission* announced the winners of the third tender under Round 1.3
- All of the 25 blocks tendered were allocated, significantly above to what the government was expecting (~20%)
- In our opinion, the allocation was very successful despite the low oil prices, given the low extraction costs in conventional onshore fields compared to other fields
- The next couple of rounds, whose bidding processes are yet to be defined, include deep-sea water exploration, as well as in the Chicontepec field

Round 1.3. The *National Hydrocarbon Commission* (CNH) announced the winners of the third tender under the so-called Round 1 (a.k.a. Round 1.3). We highlight that this round represents the third effort by the government to allow private-sector investments into full-blown oil-related projects. This package of projects included 25 production blocks in onshore fields covered a total area of 7,776 km² in Nuevo Leon, Tamaulipas, Chiapas, Tabasco and Veracruz (as shown in the map below). According to the Ministry of Energy, these zones contain hydrocarbons such as dry gas, oil, gas and condensate.

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@ analisis_fundam

Gabriel Casillas
Chief Economist and Head of Research
gabriel.casillas@banorte.com

Delia Paredes
Executive Director of Economic Analysis
delia.paredes@banorte.com

Saúl Torres
Analyst, Mexico
saul.torres@banorte.com

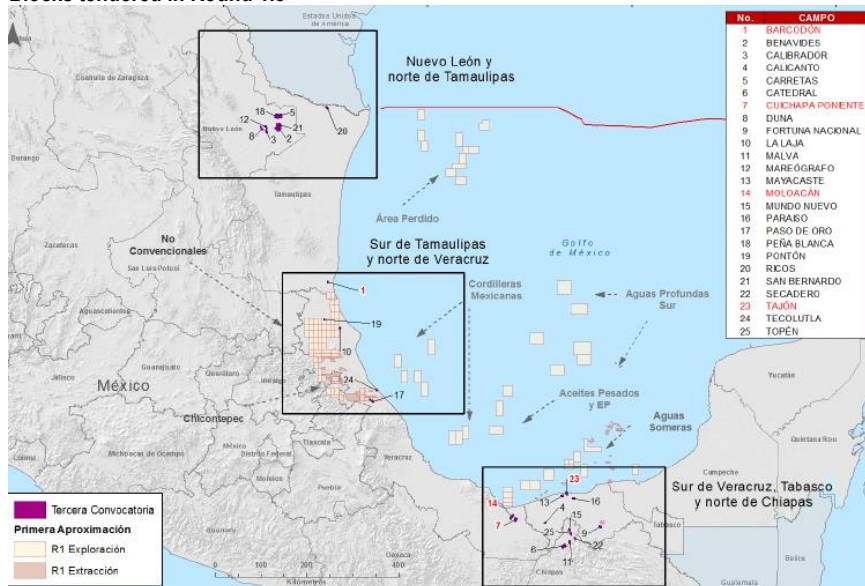
Fixed income and FX Strategy

Alejandro Padilla
Head Strategist - Fixed-Income and FX

Santiago Leal
Analyst Fixed Income and FX
santiago.leal@banorte.com

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Blocks tendered in Round 1.3



Source: Ministry of Energy

Perfect allocation. All of the 25 blocks (100%) tendered were allocated and most of the firms are Mexican, as shown in the table below. This number was significantly above to what the government was expecting (~20%), amid an environment of falling oil prices. Moreover, it is worth noting that the initial investment required to invest in conventional onshore fields is much less than what is required to explore and produce in shallow water fields, despite their low operating costs.

Winners of third bidding process

Area	Field name	Company awarded with contract (*Consortiums)	Country
Area 23	Tajón	Compañía Petrolera Perseus	Mexico
Area 7	Cuichapa-Pte	Servicios de Extracción Petrolera Lifting de México	Mexico
Area 14	Moloacán	*Canamex Dutch, Perfolat de México, American Oil Tools	Netherlands/Mexico
Area 1	Barcodón	Diavaz Offshore	Mexico
Area 15	Mundo Nuevo	Renaissance Oil	Canada
Area 16	Paraíso	*Roma Energy, Tubular Technology, GX Geoscience	USA/Mexico
Area 6	Catedral	Diavaz Offshore	Mexico
Area 25	Topén	Renaissance Oil	Canada
Area 13	Mayacaste	Grupo Diarqco	Mexico
Area 11	Malva	Renaissance Oil	Canada
Area 18	Peña Blanca	Strata Campos Maduros	Mexico
Area 2	Benavides-Primavera	*Sistemas Integrales de Compresión, Nuvoil, Constructora Marusa	Mexico
Area 9	Fortuna Nacional	Compañía Petrolera Perseus	Mexico
Area 20	Ricos	Strata Campos Maduros	Mexico
Area 12	Mareógrafo	Consortio Manufacturero Mexicano	Mexico
Area 5	Carretas	Strata Campos Maduros	Mexico
Area 19	Pontón	*Geo Estratos, Geo Estratos MXOil Exploración y Producción	Mexico
Area 24	Tecolutla	*Geo Estratos, Geo Estratos MXOil Exploración y Producción	Mexico
Area 22	Secadero	*Grupo R Exploración y Producción, Constructora y Arrendadora México	Mexico
Area 8	Duna	Construcciones y Servicios Industriales Globales	Mexico
Area 21	San Bernardo	Sarreal	Mexico
Area 3	Calibrador	Consortio Manufacturero Mexicano	Mexico
Area 10	La Laja	*Geo Estratos, Geo Estratos MXOil Exploración y Producción	Mexico
Area 4	Calicanto	Grupo Diarqco	Mexico
Area 17	Paso de Oro	*Geo Estratos, Geo Estratos MXOil Exploración y Producción	Mexico

Source: Ministry of Energy

Participants of the third public bidding process. A total of 40 participants – 26 individual companies plus 14 consortiums-, submitted documents to Round 1.3, although 11 of 51 that had pre-qualified, decided to leave the process. The bidders that submitted their envelopes with proposals are shown in the following table.

Third bidding process

1	Grupo Vordcab, in consortium with Ocm Vordcab	21	Tonalli Energía
2	Generadora y Abastecedora de Energía de México	22	Grupo Diarqco
3	Diavaz Offshore	23	Grupo Industrial de Tabasco, in consortium with Servicios Asociados
4	Citla Energy Onshore	24	Roma Energy Holdings, in consortium with Tubular Technology y Gx Geoscience Corporation
5	Geopark Limited in consortium with Newpek Exploración y Extracción	25	GPA Energy
6	Gran Tierra Energy Inc	26	Renaissance Oil Corp
7	Sun God Energía de México	27	Steel Serv, in consortium with Constructora Hostotipaquillo, Desarrollo de Tecnología y Servicios Integrales y Mercado de Arenas Sílicas
8	Geo Estratos, in consortium with Geo Estratos Mxoil Exploración y Producción	28	Construcciones y Servicios Industriales Globales
9	Compañía Petrolera Perseus	29	T5 Enemusa
10	Sarreal	30	Strata Campos Maduros
11	PetroBal, in consortium with PetroSouth Properties	31	Grupo R Exploración y Producción, in consortium with Constructora y Arrendadora México
12	Torenco Energy, in consortium with Petrodata Services	32	Tecpetrol Internacional
13	Servicios de Extracción Petrolera Lifting de México	33	Sánchez-Olium
14	Cheiron Holdings Limited	34	Iberoamericana de Hidrocarburos
15	Consortio Manufacturero Mexicano	35	Servicios PJP4 de México
16	Sistemas Integrales de Compresión, in consortium with Nuvoil y Constructora Marusa	36	Canamex Dutch, in consortium with Perfolat de México y American Oil Tools
17	Carso Oil and Gas	37	Armour Energy Limited
18	Petroleum Incremental	38	Ingeniería, Construcciones y Equipos Conequipos, in consortium with Industrial Consulting, Desarrolladora Oleum, Marat International y Constructora Tzaulan
19	Jaguar Exploración y Producción de Hidrocarburos, in consortium with Energía Americas II	39	GAT Oil&Gas
20	Controladora de Infraestructura Petrolera México	40	Caabsa Infraestructura, in consortium with Zenith Servicios Petroleros y Oleoducto Del Norte De Colombia

Source: Ministry of Energy

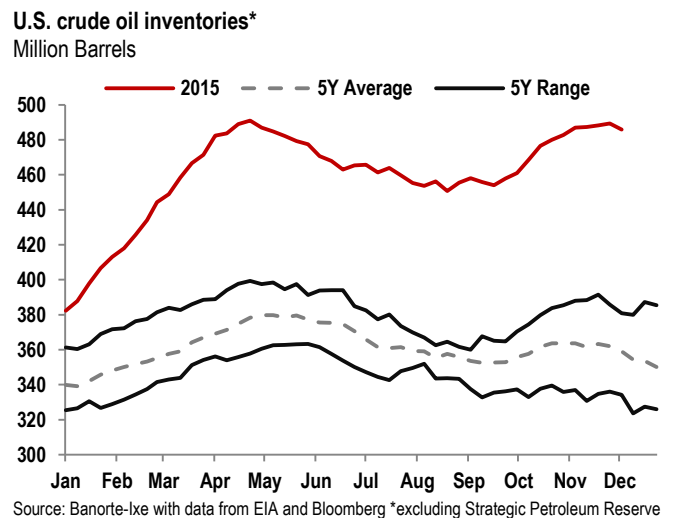
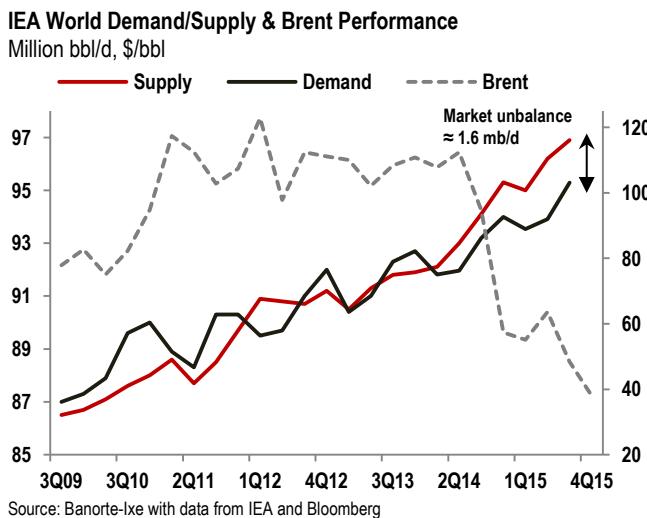
Next couple of rounds. The next couple of rounds, whose bidding processes are yet to be defined, include deep-sea water exploration, as well as in the Chicontepec field and non-conventional resources.

Excellent result. We believe that onshore fields are more attractive than in previous rounds, particularly to the interests of small firms. We highlight that many of these fields were abandoned prematurely by Pemex in the eighties, when the exploitation of Cantarell began. Nevertheless, with new technologies, the costs of extraction have been reduced relatively, and make more attractive for investment. In our opinion, the result of this round exceeded our expectations given the improvements and additional information that the government has been receiving in the previous rounds, so the government is better prepared for the next process, in which for the first time, will bid fields in deepwater and extra heavy oil, as mentioned above.

From our fixed income and FX strategy team

Oil prices have witnessed highly deteriorated dynamics since the middle of last year given global supply conditions which exceed consumption capacity as shown in the lower left chart, coupled with low market expectations of showing a strong turnaround in the short term. In particular, OPEC’s strategy to protect its market share by means of lower prices has not damaged American producers as initially expected. Nevertheless, as the room for further efficiency gains among these participants diminishes, U.S. output is expected to finally begin its gradual decline. An example of this condition is the U.S. persistent inventory buildup as depicted in the chart below on the right. This trend has taken place in a context where exports are banned for local producers, although there are strong indications of a bi-partisan agreement that could mark a shift in this 40-year paradigm shortly.

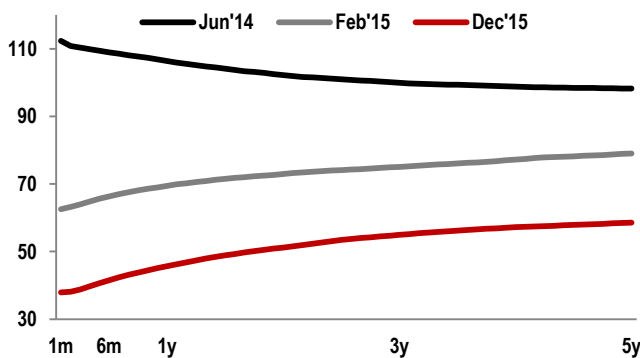
Unlike other episodes, this time price action is due to a combination of demand (explained by lower demand in China and other regions) and supply (global overproduction) shocks. Regarding the latter, U.S. output as of November 30th 2015 according to the EIA is at 9.4 mbbbl/d compared to 5.6 mbbbl/d 5 years ago. Meanwhile, the self-imposed OPEC’s production quota at 30 mbbbl/d, effective until the meeting held last December 4th, contrasts with real output which is about 1.5 mbbbl/d higher than the ceiling. In Mexico, the production platform has decreased 33.4% from April 2004 to October 2015, with current output at 2.6 mbbbl/d from 3.9 mbbbl/d and mainly due to the Cantarell-basin decay. As of yesterday’s close, WTI has slumped 65.2% from its 2014-high of 107.26 to 37.35 \$/bbl, whereas Brent traded at 38.05 \$/bbl, a 66.9% accumulated loss from last year’s high at 115.06 \$/bbl. Moreover, the Mexican Mix has lost 38.8% YTD, standing at 28.34 \$/bbl, and 73.3% lower with respect to its 2014-high at 102.41 \$/bbl.



At the same time, OPEC members such as Libya and Iraq have increased their production, Saudi output is at historical highs, and the potential lifting of sanctions to Iran would enable them to export crude once again. This context has brought nervousness regarding the possibility of finding an equilibrium from which prices could recover, coupled with moderate global growth that still outstands as a risk to the demand side. Regarding Iran, its reincorporation to global energy markets could materialize as soon as the beginning of January, although we cannot discard further delays. Likewise, it is worth mentioning that local infrastructure conditions are a significant restriction, so no flow to their full potential is expected in the short term. Additionally, production from other members (such as Nigeria, Ecuador and Venezuela) could fluctuate erratically, providing some room for Iranian barrels. Either way, some market participants have declared that these are already flowing through less regulated markets. Thus, the necessary rebalancing to support higher prices will most likely come from non-OPEC producers, as their industries have lower margins vs. their marginal costs. However, it is important to note that current market conditions will hardly allow for a strong recovery in the mid-term. In this sense, Bloomberg’s median contributor forecasts locate 60 \$/bbl for WTI during 2017 and 61.25 \$/bbl for Brent. Similarly, the same consensus expects prices to locate at 66 and 77 \$/bbl in 2019 for WTI and Brent, in the same order. Lastly, it is our take that prices could fall 5 \$/bbl more during the next six months, with latent threats derived from risks stemming from lower global economic growth.

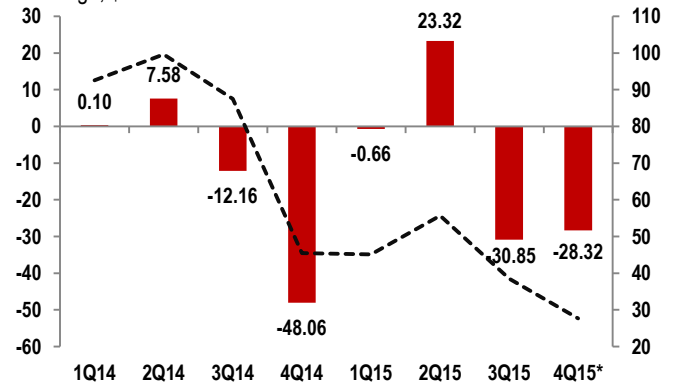
In this concern, the complex scenario can also be observed in the futures markets, where the curve’s structure has noticed sharp adjustments (see chart below on the left). Intraday trading has been characterized by high volatility, in which we add relevant impact from technical factors such as the market’s speculative position and negative correlation to the U.S. dollar. In our view, this latter reasons signal why a temporal rally could be promptly reversed. Regarding technical positions, a considerable rise has been registered over options and futures total shorts for both Brent and WTI, a situation than could trigger additional pressures for both securities as financial actors endure on a hedging strategy and producers trade more proactively in a bid to limit losses. Going forward, we expect the complex situation in the energy sector to keep prices low for longer, highlighting in the meantime American producers’ resilience to an adverse environment.

Brent Futures Curve
\$/bbl



Source: Bloomberg as of 12/14/15

Mexican Mix performance
% change, \$/bbl



Source: Banorte-ixe with data from Bloomberg *as of 12/14/15

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GRUPO FINANCIERO BANORTE S.A.B. de C.V.
Research and Strategy

Gabriel Casillas Olvera	Chief Economist and Head of Research	gabriel.casillas@banorte.com	(55) 4433 - 4695
Raquel Vázquez Godínez	Assistant	raquel.vazquez@banorte.com	(55) 1670 - 2967

Economic Analysis

Delia María Paredes Mier	Executive Director of Economic Analysis	delia.paredes@banorte.com	(55) 5268 - 1694
Alejandro Cervantes Llamas	Senior Economist, Mexico	alejandro.cervantes@banorte.com	(55) 1670 - 2972
Katia Celina Goya Ostos	Senior Global Economist	katia.goya@banorte.com	(55) 1670 - 1821
Miguel Alejandro Calvo Domínguez	Economist, Regional & Sectorial	miguel.calvo@banorte.com	(55) 1670 - 2220
Juan Carlos García Viejo	Economist, International	juan.garcia.viejo@banorte.com	(55) 1670 - 2252
Rey Saúl Torres Olivares	Analyst	saul.torres@banorte.com	(55) 1670 - 2957
Lourdes Calvo Fernández	Analyst (Edition)	lourdes.calvo@banorte.com	(55) 1103 - 4000 x 2611

Fixed income and FX Strategy

Alejandro Padilla Santana	Head Strategist – Fixed income and FX	alejandro.padilla@banorte.com	(55) 1103 - 4043
Juan Carlos Alderete Macal, CFA	FX Strategist	juan.alderete.macal@banorte.com	(55) 1103 - 4046
Santiago Leal Singer	Analyst Fixed income and FX	santiago.leal@banorte.com	(55) 1670 - 2144

Equity Strategy

Manuel Jiménez Zaldivar	Director Equity Research — Telecommunications / Media	manuel.jimenez@banorte.com	(55) 5268 - 1671
Victor Hugo Cortes Castro	Equity Research Analyst	victorh.cortes@banorte.com	(55) 1670 - 1800
Marissa Garza Ostos	Senior Equity Research Analyst – Conglomerates/Financials/ Mining/ Chemistry	marissa.garza@banorte.com	(55) 1670 - 1719
Marisol Huerta Mondragón	Equity Research Analyst – Food/Beverages	marisol.huerta.mondragon@banorte.com	(55) 1670 - 1746
José Itzamna Espitia Hernández	Equity Research Analyst – Airports / Cement / Infrastructure / Fibras	jose.espitia@banorte.com	(55) 1670 - 2249
Valentín III Mendoza Balderas	Equity Research Analyst – Auto parts	valentin.mendoza@banorte.com	(55) 1670 - 2250
María de la Paz Orozco García	Analyst	maripaz.orozco@banorte.com	(55) 1670 - 2251

Corporate Debt

Tania Abdul Massih Jacobo	Director Corporate Debt	tania.abdul@banorte.com	(55) 5268 - 1672
Hugo Armando Gómez Solís	Analyst, Corporate Debt	hugo.gomez@banorte.com	(55) 1670 - 2247
Idalia Yanira Céspedes Jaén	Analyst, Corporate Debt	idalia.cespedes@banorte.com	(55) 1670 - 2248

Wholesale Banking

Armando Rodal Espinosa	Head of Wholesale Banking	armando.rodal@banorte.com	(55) 1670 - 1889
Alejandro Eric Faesi Puente	Head of Global Markets and Institutional Sales	alejandro.faesi@banorte.com	(55) 5268 - 1640
Alejandro Aguilar Ceballos	Head of Asset Management	alejandro.aguilar.cebillos@banorte.com	(55) 5268 - 9996
Arturo Monroy Ballesteros	Head of Investment Banking and Structured Finance	arturo.monroy.ballesteros@banorte.com	(55) 5004 - 1002
Gerardo Zamora Nanez	Head of Transactional Banking, Leasing and Factoring	gerardo.zamora@banorte.com	(81) 8318 - 5071
Jorge de la Vega Grajales	Head of Government Banking	jorge.delavega@banorte.com	(55) 5004 - 5121
Luis Pietrini Sheridan	Head of Private Banking	luis.pietrini@banorte.com	(55) 5004 - 1453
René Gerardo Pimentel Ibarrola	Head of Asset Management	pimentelr@banorte.com	(55) 5268 - 9004
Ricardo Velázquez Rodríguez	Head of International Banking	rvelazquez@banorte.com	(55) 5004 - 5279
Victor Antonio Roldan Ferrer	Head of Corporate Banking	victor.roltan.ferrer@banorte.com	(55) 5004 - 1454