

Round 3.1 – Results beat Federal Government’s forecast once again

- The *National Hydrocarbon Commission* (CNH) announced the winners of Round 3.1
- This round contemplated 35 shallow-water fields in the Gulf of Mexico, spanning a surface of 10,140 sq. miles
- Out of the 35 fields tendered, 16 were allocated (45.7%), below the 66.8% historical average, but standing above the government’s own expectation (~25%)
- We consider that the allocation was successful, showing a continuing interest of companies in the development the Mexican energy sector
- The next step in the allocation process will be Round 3.2, which will take place on July 25, and it will include 37 onshore fields in Burgos, Tampico-Misantla-Veracruz and the Southeastern Basin
- Crude oil prices trading defensively despite U.S. output hitting all-time highs

Round 3.1. The *National Hydrocarbon Commission* (CNH) announced the winners of the first tender under the so-called Round 3 (a.k.a. Round 3.1). We highlight that this round represents the ninth effort by the government to allow private-sector investments to invest in full-blown oil-related projects. Eighteen bidders came forth, 4 being individual companies and 14 associations between 2 or more companies. All 18 took part in the final process and 12 were awarded a contract. This group of projects included 35 production blocks in shallow water fields, which covered a total area of 26,262 km² (10,140 sq. miles). Fourteen blocks are located in the area known as Burgos on the coasts of Tampico, thirteen more are in the Tampico-Misantla-Veracruz region on the coasts of Veracruz and another eight in the Southeaster Basin on the coasts of Veracruz, Tabasco and Campeche (as shown on the map on the next page). According to the Ministry of Energy, these zones mainly contain hydrocarbons such as oil as well as dry and wet gas.

Favorable result, once again. It should be noted that in Round 3.1, 45.7% of the possible blocks were allocated (16 out of 35), where we highlight that *Pemex*, either in a consortium or individually, got 8 of the blocks tendered. We also highlight the participation of *Deutsche Erdoel* and *Total* that got 3 blocks each with different consortiums. This result was better than the one expected by the Federal Government that expected an allocation of around 25% due to the difficulty involved in the development of natural gas projects, given current low prices in North America. In our view, the success achieved in this round continues to reflect the interest from companies to continue investing in this type of projects in Mexico.

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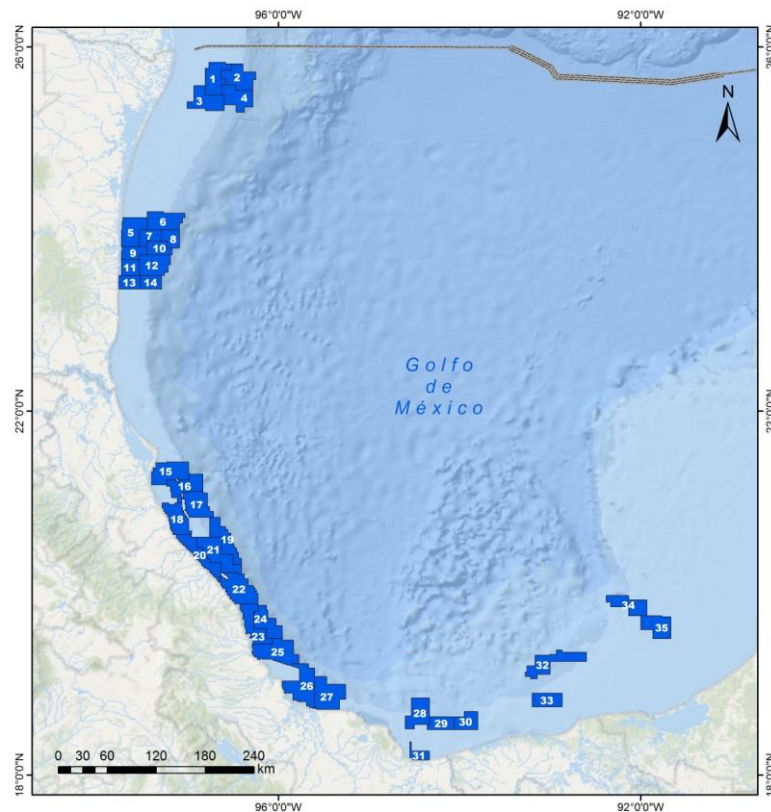
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Blocks tendered in Round 3.1



Source: National Hydrocarbon Commission

Results of fields allocated in Burgos

Area	Surface (sq. km.)	Hydrocarbon to exploit	Bidder	Country of origin	Government's additional profit margin (%)	Additional investment factor	Weighted value of the economic proposal
1. Burgos	802	Wet gas					
2. Burgos	816	Wet gas					
3. Burgos	809	Wet gas					
4. Burgos	778	Wet gas					
5. Burgos	814	Oil and wet gas	Repsol	Spain	56.27	0.0	56.270
6. Burgos	820	Oil					
7. Burgos	391	Oil					
8. Burgos	390	Oil					
9. Burgos	397	Oil					
10. Burgos	419	Oil					
11. Burgos	391	Oil	Premier Oil	UK	29.43	0.0	29.430
12. Burgos	811	Oil and wet gas	Repsol	Spain	48.17	0.0	48.170
13. Burgos	392	Oil	Premier Oil	UK	34.73	0.0	34.730
14. Burgos	392	Oil					

Source: SENER, CNH

Results of fields allocated in Tampico-Misantla-Veracruz

Area	Surface (sq. km.)	Hydrocarbon to exploit	Bidder	Country of origin	Government's additional profit margin (%)	Additional investment factor	Weighted value of the economic proposal
15. Tampico-Misantla-Veracruz	962	Oil and wet gas	Capricorn Energy and Citla Energy	UK and Mexico	27.88	0.0	27.880
16. Tampico-Misantla-Veracruz	785	Oil	Pemex, Deutsche Erdoel and Compañía Española de Petróleos	Mexico, Germany and Spain	24.23	0.0	24.230
17. Tampico-Misantla-Veracruz	842	Oil	Pemex, Deutsche Erdoel and Compañía Española de Petróleos	Mexico, Germany and Spain	35.51	0.0	35.510
18. Tampico-Misantla-Veracruz	813	Oil	Pemex and Compañía Española de Petróleos	Mexico and Spain	40.51	0.0	40.510
19. Tampico-Misantla-Veracruz	808	Oil			Deserted		
20. Tampico-Misantla-Veracruz	817	Oil and dry gas			Deserted		
21. Tampico-Misantla-Veracruz	1,103	Dry gas			Deserted		
22. Tampico-Misantla-Veracruz	1,138	Dry gas			Deserted		
23. Tampico-Misantla-Veracruz	820	Dry gas			Deserted		
24. Tampico-Misantla-Veracruz	791	Dry gas			Deserted		
25. Tampico-Misantla-Veracruz	1,170	Dry gas			Deserted		
26. Tampico-Misantla-Veracruz	1,225	Wet and dry gas			Deserted		
27. Tampico-Misantla-Veracruz	1,218	Wet and dry gas			Deserted		

Source: SENER, CNH

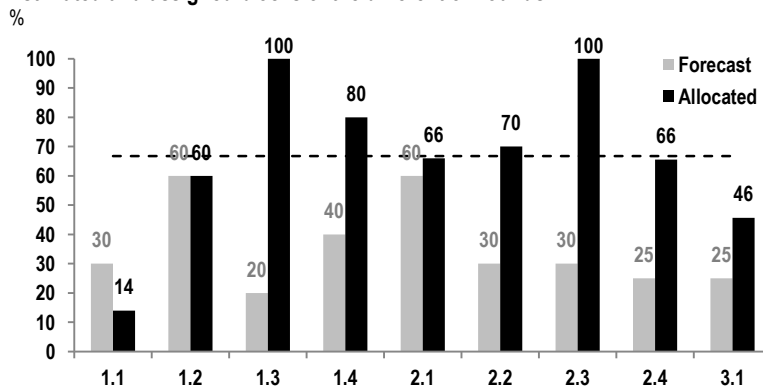
Results of fields allocated in the Southeastern Basin

Area	Surface (sq. km.)	Hydrocarbon to exploit	Bidder	Country of origin	Government's additional profit margin (%)	Additional investment factor	Weighted value of the economic proposal
28. Southeastern Basin	808	Oil	Eni and Lukoil	Italy and Russia	65.00	1.5	73.967
29. Southeastern Basin	471	Oil	Pemex	Mexico	65.00	1.5	73.967
30. Southeastern Basin	528	Oil	Deutsche Erdoel, Premier Oil and Sapura E&P	Germany, UK and Malaysia	65.00	1.5	73.967
31. Southeastern Basin	401	Oil	Pan American Energy	Argentina	65.00	1.0	70.978
32. Southeastern Basin	1,027	Oil	Total and Pemex	France and Mexico	40.49	0.0	40.490
33. Southeastern Basin	581	Oil	Total and Pemex	France and Mexico	50.49	1.0	55.638
34. Southeastern Basin	734	Oil and wet gas	Total, BP and Pan American Energy	France, UK and Argentina	50.49	1.0	55.638
35. Southeastern Basin	798	Oil	Shell and Pemex	Netherlands and Mexico	34.86	0.0	34.860

Source: SENER, CNH

Continuing success in oil field auctions. The bidding process for the oil rounds has had an average allocation of 66.8%. It should be noted that round 1.3 and 2.3 have been the most successful ones, with a 100% allocation, as shown in the following graph.

Estimated and assigned blocks of the different oil rounds



Source: Banorte, National Hydrocarbon Commission

Round 3.2 will take place on July 25. It will involve 37 onshore fields, of which 21 are set in the *Burgos* basin –in Tamaulipas–, 9 are located the region known as *Tampico-Misantla-Veracruz* in Veracruz. Finally, the remaining 7 are situated in the Southeastern Basin in Veracruz and Tabasco.

From our fixed income and FX strategy team

Crude oil prices trading defensively despite U.S. output hitting all-time highs. During the last weeks, crude oil prices have witnessed a positive performance supported by a number of factors that are supporting a constructive view for the market. However, relentless U.S. production poses the risk of echoing the oversupply narrative seen back in 2014. Despite a widely expected recovery, U.S. production has increased around 6% this year –according to DOE weekly estimates– at approximately 10.4 Mbbl/d. In context, this figure puts the U.S. above Saudi Arabia as the second top producer in the world, only surpassed by Russia. The DOE is actually expecting 2018 output to average 10.7 Mbbl/d which would result in a new all-time high, breaching the previous record of 9.6 Mbbl/d set in 1970. Moreover the agency forecasts average production of 11.3 Mbbl/d for 2019.

Despite this considerable flow in terms of supply, prices have traded very defensively in recent weeks (see figure 1). Even considering the sharp adjustment in financial markets in February and additional pressures at the beginning of the current month, global benchmarks are trading close to levels not seen since 2014. Specifically Brent is at 70.16 \$/bbl, equivalent to a 5% rally from year-end 2017, and +12% from this year's lowest point, whereas its highest market stood at 71.28 \$/bbl at the end of January.

Broadly speaking, these dynamics are explained by the effect of OPEC's and its ally's production cut agreement, coupled with solid data and expectations about global consumption going forward. However, more recently it is important to note the influence of the weakening dollar and how growing tensions in the Middle East have been factored-in by the market. Regarding the latter, investors are discussing the level in which a harder-line of the U.S. towards Iran could affect crude flow, particularly considering John Bolton's assignment as new National Security Adviser and his views on the current nuclear agreement. Additionally, Venezuela's oil industry disrepair has stayed as one of the main factors that could also push prices higher.

As our central scenario, we believe prices could moderate during the year closing near 65 \$/bbl given the possibility of global inventories growing again. Nevertheless, we acknowledge that risks are tilted to the upside as the case for an extension of OPEC and its allies (including Russia) production agreement is building up, and conflicts and geopolitical conditions mentioned before have not dissipated. In this respect, the market is still signaling tighter conditions for global balances, mainly when analyzing time spreads and a futures curve that remains in backwardation. For example, the spread between the 1st and the 7th month has strengthened, suggesting a market which prices-in tighter conditions for the second half of this year (see figure 2).

Fig. 1 Brent and MexMix performance

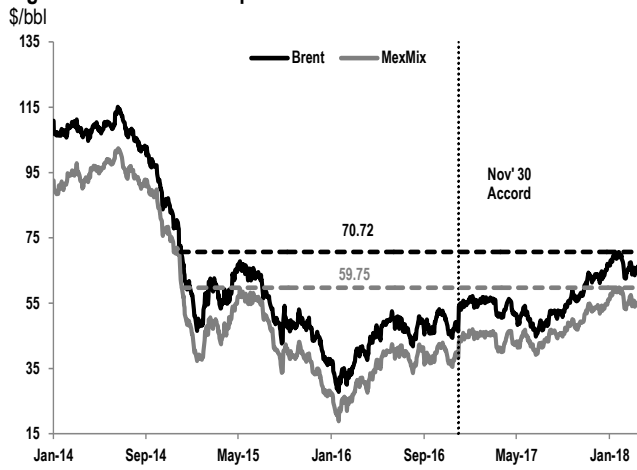
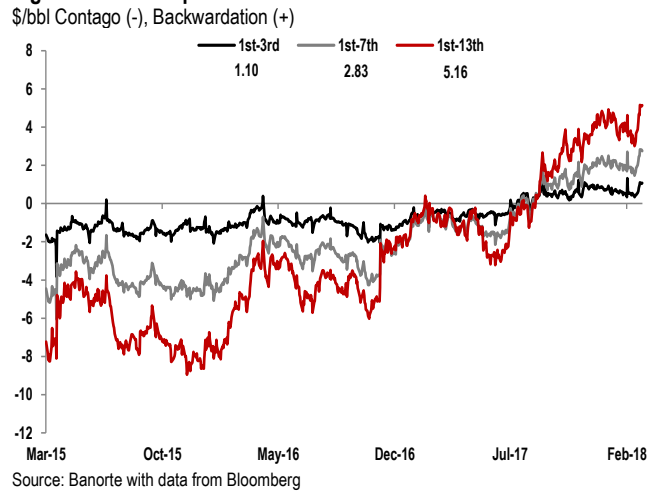


Fig. 2 Brent time spreads



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