Economic Analysis

Pemex’s Business Plan 2019–2023: Marginal but Insufficient Progress

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- **The plan includes measures to strengthen Pemex's finances and production capacity, but they do not solve the company's two major structural problems: excessive financial indebtedness and a relatively high tax burden**
- **We think it is necessary to reactivate farmouts to enable the significant increases in oil production planned for the last three years of AMLO’s government**

Pemex’s Business Plan 2019–2023 is mainly based on more capital contributions from the federal government and a reduction of its tax burden, with the purpose that Pemex invests more resources during the first half of AMLO’s six-year stint. The purpose is not only to stabilize crude oil production, but also to significantly increase it during the second half of the six-year period to an average of 2.7 million barrels per day (MMbpd) by 2024 — up from an average of 1.7 MMbpd in 2019 according to Pemex’s estimations. Moreover, this plan also seeks to ensure that the management of the company is underpinned by innovation, efficiency and the elimination of corruption.

The planned capital injections from the federal government during 2020–2022 will total 141,000 million pesos and the tax burden will decrease by 128,000 million pesos during the same period. Most of this financial support will be provided in 2020 and 2021 with amounts of 111,000 million pesos and 121,000 million pesos, respectively. Pemex also expects that comprehensive service contracts will contribute 94,000 million pesos during 2020–2022. All of the above measures would allow investment in nominal pesos to increase YoY at rates of 27.1% in 2020 and 18.4% in 2021. In other words, Pemex's investment level would increase to 411,000 million pesos in 2021 vs. 273,000 million pesos of approved investment for this year.

In regard to the reduction of the tax burden, this will imply a cut to the rate of DUC (*Derecho por Utilidad Compartida*) from the current rate of 65% to 58% in 2020 and then to 54% in 2021. Nevertheless, a reform to the Mexican Hydrocarbon Revenue Law will be required to make such rate cuts possible. Meanwhile, the federal government plans to compensate for the income lost from these tax cuts through savings (24,000 million pesos from the development of new fields and 50,000 million pesos from the fight against fuel theft) and higher tax revenue.

In order to increase crude oil production in the coming years, Pemex's strategy aims at reducing times between commercial discovery and production. The company will also seek to intensify land and shallow waters exploration around the vicinity of active production fields. As private participation is concerned, it will only be allowed through long-term incentive contracts (also known as comprehensive exploration and extraction services contracts). For the time being, the reactivation of farmouts does not seem to be an option under consideration for the federal government for the coming years. As for the development of the new refinery, Pemex's Board of Directors approved a budget of 41,000 million pesos for 2020.

Concluding remarks

Although the business plan includes some measures to strengthen both Pemex's finances and production capacity, we believe that they are insufficient to solve the company's two major structural problems: excessive financial indebtedness and a relatively high tax burden. It is worth mentioning that the announced measures will probably contribute to the stabilization of crude oil production, but we consider that the likelihood of significant increases in crude oil production in such a short time frame remains low. We insist that the farmout-based business model should be reactivated to make such increases possible. This would allow Pemex to share not only exploration risks, but also investment and technological know-how, with other leading companies in the O&G industry.

In our view, the permanent reduction of Pemex's tax burden that the federal government plans to implement over the next two years, and the possible additional contribution of resources to Pemex beyond 2022, should be supplemented with changes in tax policies that help keep federal government revenues relatively stable and do not risk meeting fiscal targets. This would contribute to strengthening the country's public finances, thereby lowering the risk of a reduction in the sovereign credit rating in the short- and medium-term. Nevertheless, the business plan does not alter the risk of a downgrade to Pemex's credit rating by Moody's.