BBVA | RESEARCH

Opportunities from Mexico's Energy Reform

Conference Call

January 28th, 2014

BBVA | RESEARCH

Agenda

1 Mexico's Energy Reform

2 Implications for the United States

3 Uncertainties

4 Conclusion

5 Q&A

Mexico’s Energy Reform

- The **state** retains the ownership of hydrocarbons below the surface
- However, the reform allows **possession of hydrocarbons at the wellhead**
- Private companies are allowed to partner with PEMEX in **every stage of the value chain**
- Three basic forms of contracts: **production-sharing, profit-sharing and licenses**
- The privatization of PEMEX and CFE, the oil and electricity state companies, is **prohibited**

Mexico's Energy Reform

- Private companies allowed to participate in the **generation and distribution of electricity**
- PEMEX and CFE are restructured to become **"state-owned productive enterprises"** with the explicitly mandate create economic value for the state
- The **Mexican Petroleum Fund for Stabilization and Development** will manage states revenues from oil contracts
- **Transparency and accountability** are enhanced with stronger regulatory entities and anti-corruption measures

Timeline for Reform

Changes are expected as soon as mid-2014

Phase 1

In December 2013, President Enrique Peña Nieto signed into law changes to Articles 25, 27 and 28

Phase 2.

Congress is expected to legislate on the details of contracts with private companies, the terms for the participation of private companies in the electricity sector, and the characteristics of new regulators.

Phase 3

Simultaneously to Phase 2, PEMEX will have 90 days to decide which E&P assets to retain. Regulators have 120 days to give their approval

Phase 4

PEMEX will move some of its assets to the new contract framework and seek for joint ventures with private companies,

Phase 5

Regulators will conduct the first bids for licenses on deep water acreage. PEMEX is expected to compete on equal footing

Constitutional Reform	Secondary Laws	Round Zero	Joint Ventures	First auctions
Dec,2013	2014			2015

Opportunities for private firms

U.S. firms have the technology and experience to revive Mexico's hydrocarbon industry

Upstream

- Shallow waters and onshore: private investments needed to boost recovery rates
- Deep water: Mexico has less than 5% of total deep water rigs in the Gulf of Mexico,
- Shale oil and gas: Mexico has the sixth largest technically recoverable reserves of shale gas and the eighth largest technically recoverable reserves of shale oil in the world

Midstream

- Pipelines, railroads, and vessels will be needed to move the hydrocarbons from the production centers to their final destinations
- Exports: 80% of all the gas Mexico imports comes from the U.S. and 60% comes directly from pipelines in Texas

Downstream

- Refining: increasing demand and production will require adding refining capacity. Joint ventures are possible.

Macroeconomics

The U.S. will benefit from a stronger Mexican economy

GDP

- Energy reform is expected to increase Mexico's GDP growth by between 1.0% and 1.5%
- Faster growth in Mexico implies higher demand for U.S. exports

FDI

- Mexico is expected to receive between $20 to $30bn of FDI per year
- A significant portion of FDI inflows will come from U.S. companies

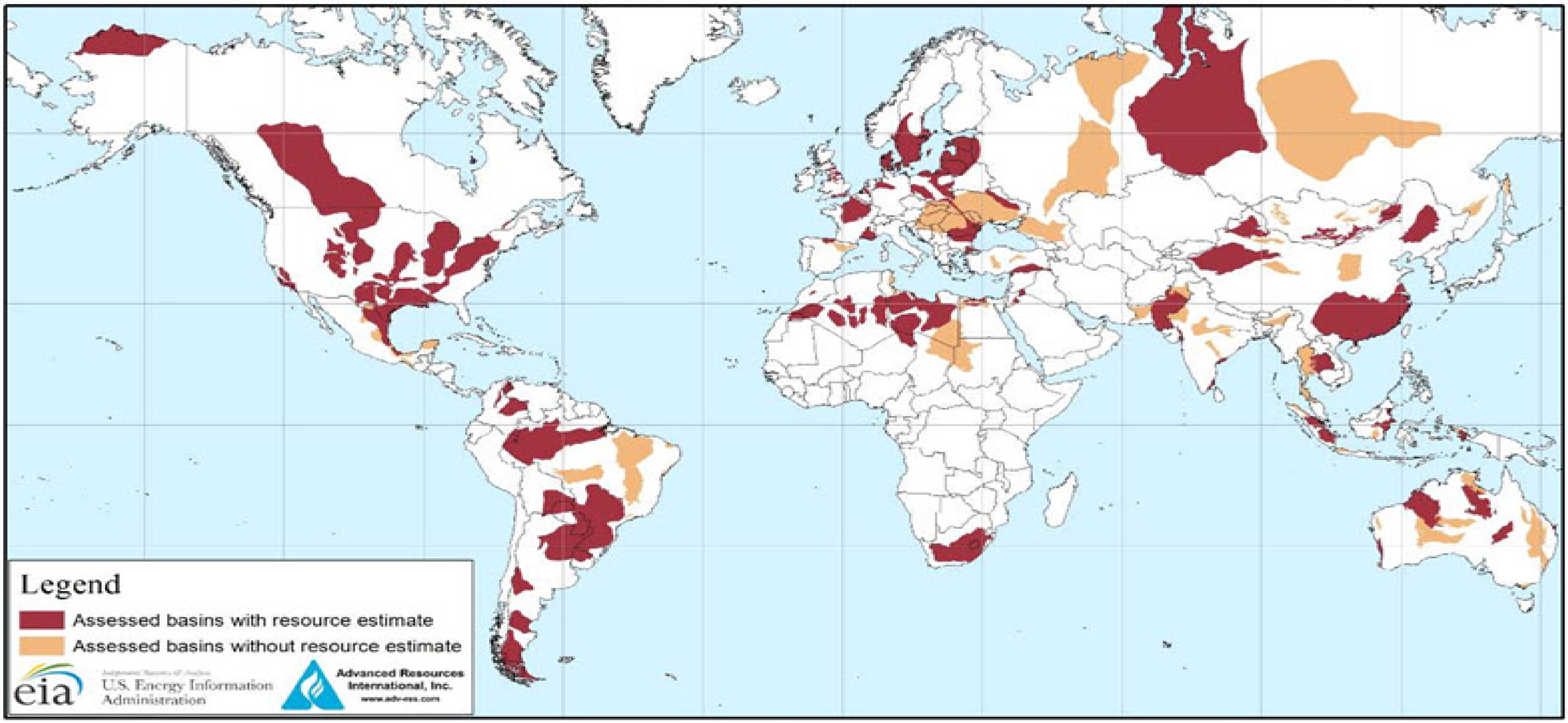
Employment

- According to government estimates, the reform could create 2.5 million jobs by 2025
- More jobs in Mexico could potentially reduce illegal immigration.

Energy independence

Developing Mexico's hydrocarbon riches will add production capacity and strengthen the energy security of North America

Figure 1. Map of basins with assessed shale oil and shale gas formations, as of May 2013



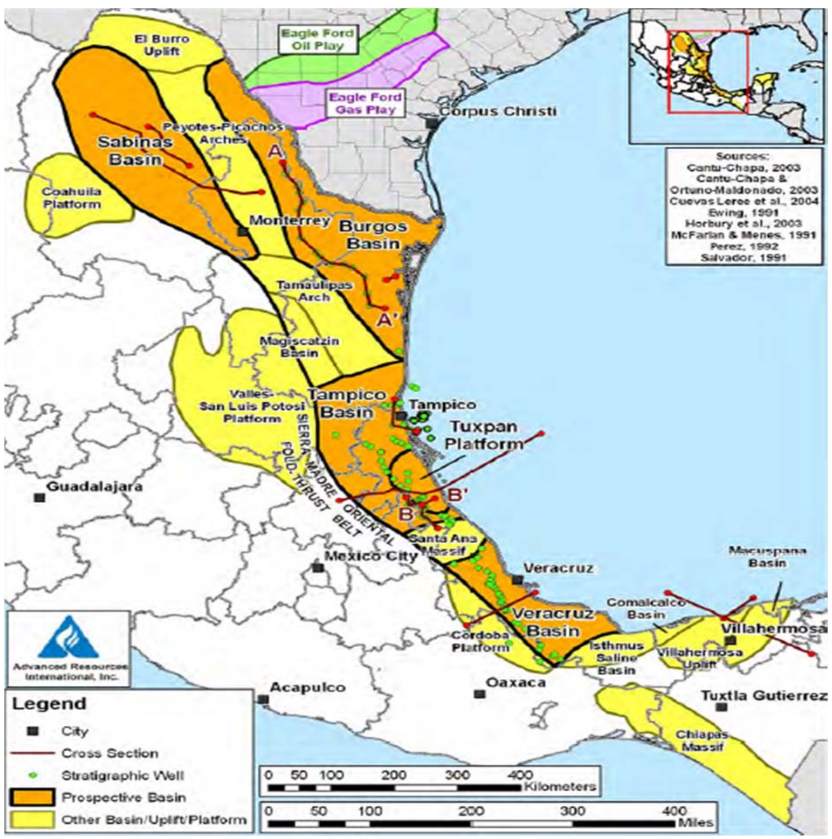
Source: United States basins from U.S. Energy Information Administration and United States Geological Survey; other basins from ARI based on data from various published studies.

Regional impact

The Texas-Mexico border could experience a dramatic transformation

Onshore shale gas basins of Eastern Mexico

Source: Energy Information Administration



38 mn

- The Eagle Ford Shale extends over Texas and the Mexican states of Tamaulipas, Nuevo Leon, and Coahuila.
- This region has a combined population of 38 million (slightly bigger than Canada)

$1.2 trn

- Assuming that one third of projected FDI goes to the Burgos Basin, the region could add between $0.8 and $1.2trn to GDP over then next ten years

Uncertainties

Secondary laws are crucial for success

Economic

- **Prices:** natural gas prices are very low
- **Volatility:** shocks to oil prices can reduce profitability
- **Competition:** Mexico is late to the shale revolution

Institutions

- **Secondary laws:** contracts should be attractive enough to incentivize investments
- **Regulation:** institutions must be strong, independent and accountable to guarantee a level playing field

Conclusion

- Mexico's energy reform will offer abundant opportunities to U.S. and foreign companies across energy and non-energy industries
- Mexico is expected to regain its position as one of the top producers of hydrocarbons, strengthening macroeconomic stability and energy security in North America
- The multiplier effect of energy investments will give a boost to the Texas-Mexico border area, generating $1.2 trillion dollars in economic activity over the next 10 years
- Last but not least, the success of the reform will depend on the quality of the implementation process

Thank you!

Let us know what you think!

To receive our publications send us an email:
researchusa@bbvacompass.com

Follow us on Twitter: @BBVAresearchUSA
and on Vimeo: https://vimeo.com/bbvaresearchusa

More information on the Web: www.bbvaresearch.com

BBVA | RESEARCH

Opportunities from Mexico's Energy Reform

Conference Call

January 28th, 2014