Pemex Q2-20 financial results: Sailing through the storm with a sovereign captain.

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- Last Tuesday, Pemex released its quarterly financial report as of Q2-2020. Overall numbers displayed the negative impact of the real economy on the operating level. The FX supports financial operations in the reference period, relative to the first quarter of the year.
- An annual reduction of revenues by around a half, despite a relative decrease in expenditures, contributed to reducing the operating result, accumulating a USD 0.03 Bn as of June.
- Renewed risk-on sentiment across global markets contributed to an FX appreciation in Q2, thus reducing the size of the negative impact on exchange rate operations. Still, the company accumulates a USD 18.3 Bn in this concept.
- Main market concerns point towards the company's ability to fulfill its debt obligations for the rest of the year. According to Pemex, USD 11.5 Bn are due from June to December, of which around 40% come from the credit revolving lines.
- A combination of a) a renewal of the outstanding amount in credit revolving lines, b) the remaining available share of those lines, and c) further government support, should be enough to pay out current 2020 maturities.
- Yet, additional borrowing needs resulting from a severely deteriorated macro-environment, are likely to emerge in H2, therefore increasing the likelihood of seeing more substantial sovereign support. Observing a narrowing of credit spreads, particularly in the worst-case scenario, remain high.

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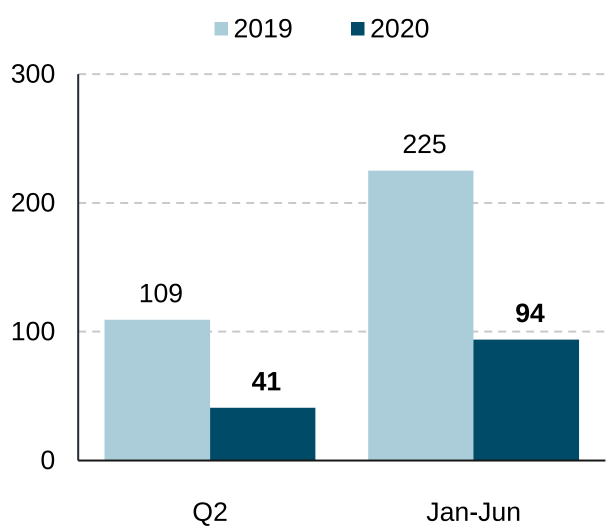
As of Q2-2020 Pemex registered an MXN 465.8 Bn gross revenue, figure 36% lower than that of a year ago:

- The YoY decline is explained by lower oil prices, coupled with a reduction in the oil platform, seemingly aligned to the OPEC+ agreement to reduce global production.
- In Q2-2020, the Mexican oil mix registered an average price of 23.3 dollars per barrel (dpb), 62% lower than the Q2-2019 average of 61.3 dpb.
- On the production side, Pemex averaged 1,647 thousand barrels daily (kbd) in Q2-2020, 1.4% below the 1,670 kbd production level of Q2-2019.
- Sales costs also reduced by 28% YoY, from MXN 548.3 Bn as of Q2-2019 to MXN 396.2 Bn as of Q2-2020.

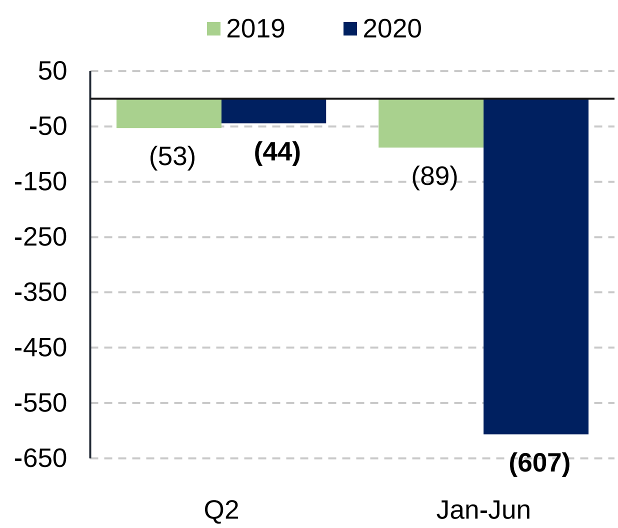
As a result, Pemex EBITDA as of Q2-2020 declined by 58% YoY, from MXN 225 to 94 Bn. The latter contributed to a net loss of MXN 607 Bn, 6.8x times the MXN 89 Bn loss registered a year before (see Figures 1a and 1b).

Figure 1a. Pemex EBITDA (MXN Bn)



Source: Finamex Economic Research with data from Pemex.

Figure 1b. Pemex Net result (MXN Bn)

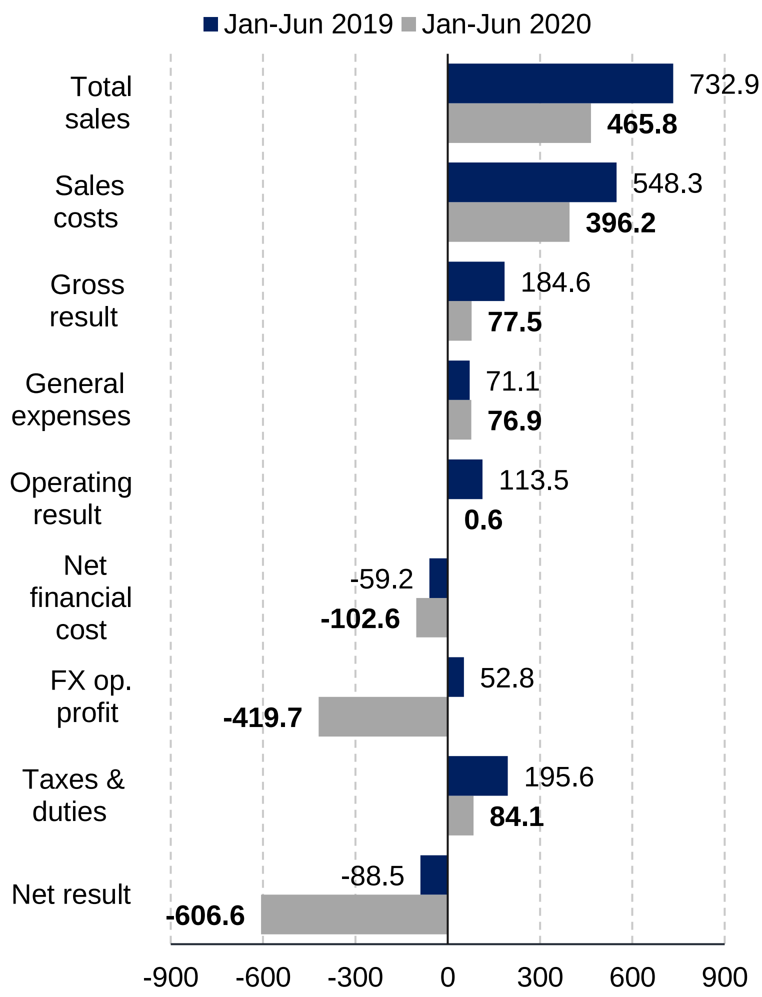


Source: Finamex Economic Research with data from Pemex.

The breakdown of Q2-2020 numbers shows the following (see Figure 2):

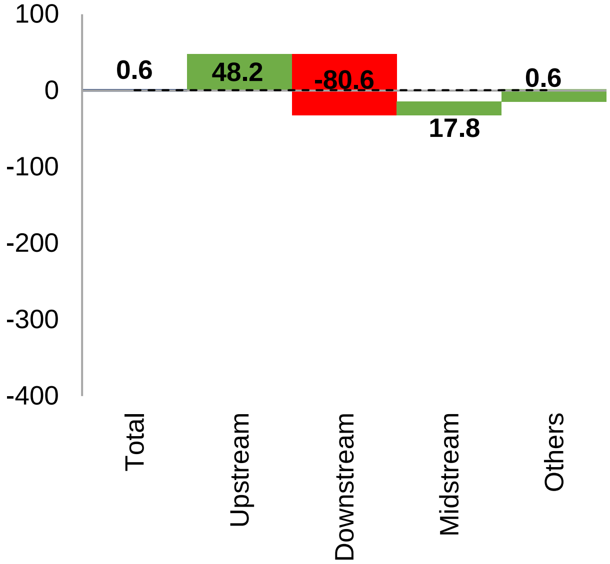
- Gross margin dropped by MXN 107.0 Bn, as lower revenues outpaced the decline in sales costs.
- General expenses increased by MXN 5.8 Bn, turning in a smaller operating result by MXN 112.9 Bn.
- Additionally, the net financial cost raised by MXN 43.4 Bn YoY in Q2-2020.
- Notably, FX operations recovered notably relative to Q1. Despite this, they showed a YoY deterioration of MXN 472.5 Bn.
- Once again, the tax relief applicable to the profit-sharing duty (DUC for its Spanish acronym) contributed to an MXN 111.5 Bn reduction in taxes.

Figure 2. H1-2020 Financial results (MXN Bn)



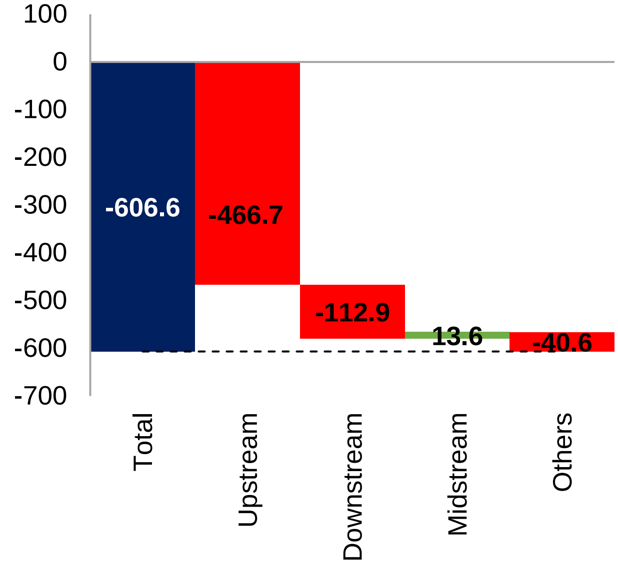
Source: Finamex Economic Research with data from Pemex.

Figure 3a. Q2-2020 Operating result by segment (MXN Bn)



Source: Finamex Economic Research with data from Pemex.

Figure 3b. Q2-2020 Net result by segment (MXN Bn)



Source: Finamex Economic Research with data from Pemex.

Pemex registered a USD 26.4 Bn net loss in H1-2020. The segment breakdown shows a USD 20.3 Bn loss in the upstream sector, a USD 4.9 Bn loss in the downstream branch, and a USD 0.6 Bn net gain in logistics.

The upstream sector managed to report an MXN 48 Bn operating surplus, reflecting the pandemic's negative impact at the international and domestic levels. Once considering all other obligations, particularly those affected by FX volatility and the tax burden, this branch's net result resulted in an MXN 467 Bn as of H1-2020.

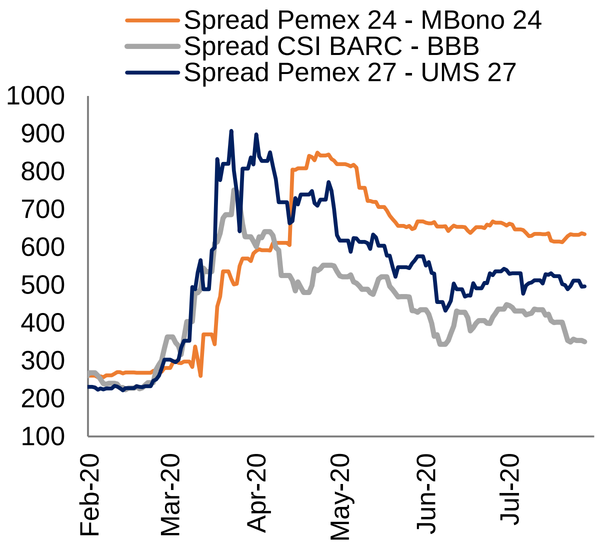
Industrial transformation, the downstream segment, contributed again to deteriorate the figures. As of Q2-2020, this segment reported an MXN 80 Bn operating loss, which increased to an MXN 113 Bn loss on a net basis after including all other obligations. In this case, the negative shock to revenues is worth considering amid the local fuel markets' sluggish dynamics.

Logistics, the midstream branch, exhibited operating and net gains, which reduced the company's overall negative results. The company's remaining five segments (fertilizers, ethylene, international trading, corporate, and subsidiaries) registered a net loss of MXN 40.6 Bn (see Figures 3a and 3b.)

The main market concerns point towards the company's ability to fulfill its debt obligations for the rest of the year. According to Pemex, USD 11.5 Bn are due from June to December. Around 40% of these needs come from credit revolving lines. Hence, a combination of a) a renewal of the outstanding amount in credit revolving lines, b) the remaining available share of those lines, and c) further government support, should be enough to pay out current 2020 maturities.

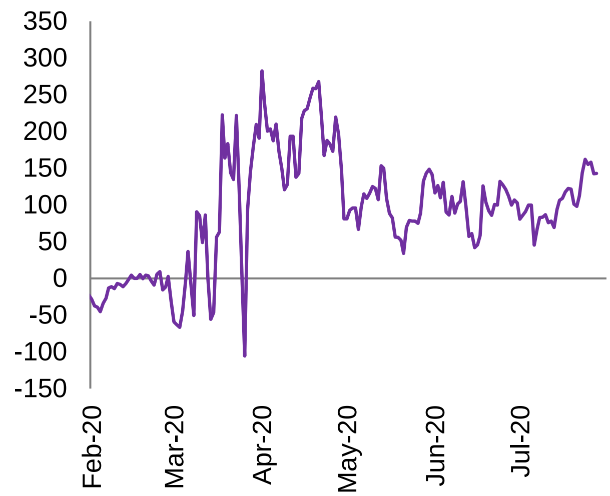
Yet, additional borrowing needs resulting from a severely deteriorated macro-environment, are likely to emerge in H2-2020, increasing the likelihood of seeing additional sovereign support. The chances of observing a narrowing of credit spreads, particularly in the worst-case scenario, remain high. Those hard currency levels trade around 500 basis points and around 635 basis points in soft currency (see Figures 4a and 4b).

Figure 4a. Pemex-Sovereign spreads (Bp)



*CSI BARC refers to YTW of the Barclays Capital US Corporates high yield, and CSI BBB to BBB US Corporates. Source: Finamex Economic Research with data from Bloomberg.

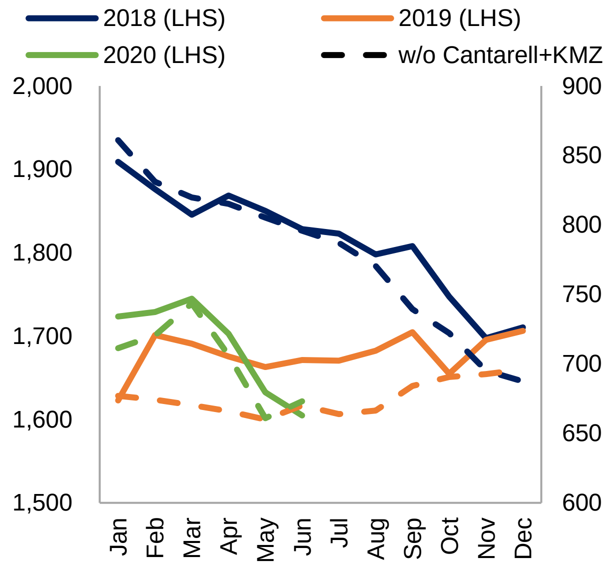
Figure 4b. Pemex-High Yield box spread (Bp)



Source: Finamex Economic Research with data from Bloomberg.

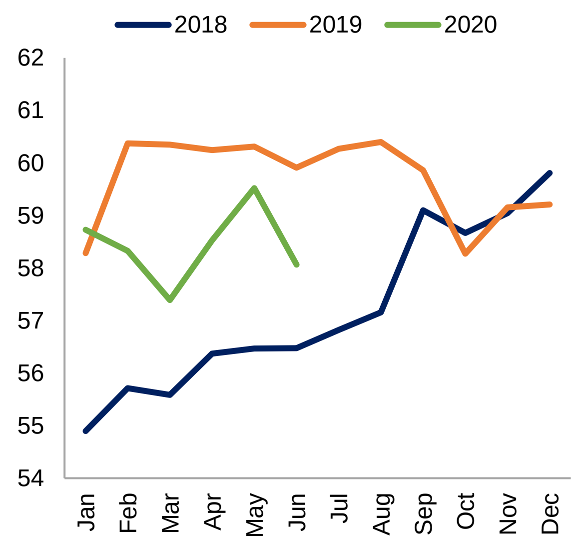
After a reticent attempt to reduce its production's reliance on the mature fields of Cantarell and Ku-Maloob-Zaap, the share of both fields total production continues around 60% (see Figures 5a and 5b). According to the company, the reduction aims to comply with the OPEC+ agreement to reduce global oil production. However, the harsh constraint in the flow of revenues also reduced the ability to exert expenditures across all segments. Current announcements of the company to reduce spending are precisely allocated on CAPEX. Once the output levels hit the record low of 1,600 kbd, the chance to see a further reduction of oil production in H2 is relatively higher than those of an increase.

Figure 5a. Pemex oil production (Kbd)



Source: Finamex Economic Research with data from Ministry of Energy.

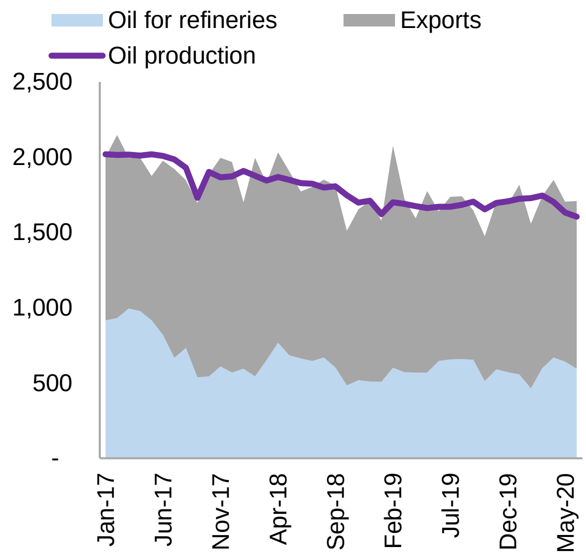
Figure 5b. Share of Cantarell + KMZ in total oil production (%)



Source: Finamex Economic Research with data from Ministry of Energy.

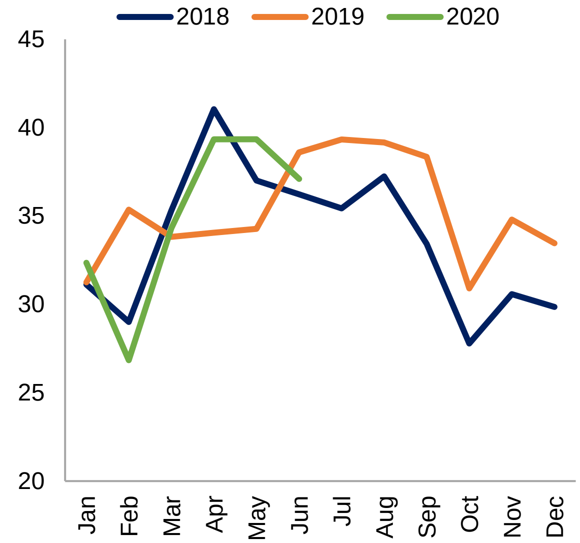
Another issue that captured markets' attention relates to refining figures. Total oil supply to local refineries amounted to 636 kbd, a 6.8% annual increase. The latter threatens Pemex's market quotas in international markets and increases the risk of exposure to the domestic market's recovery. In this line, the current share of total production allocated to local refineries has slightly increased to around 38.6%, above the 35.6% reported in Q2 a year ago (see Figures 6a and 6b).

Figure 6a. Allocation of Pemex oil production (Kbd)



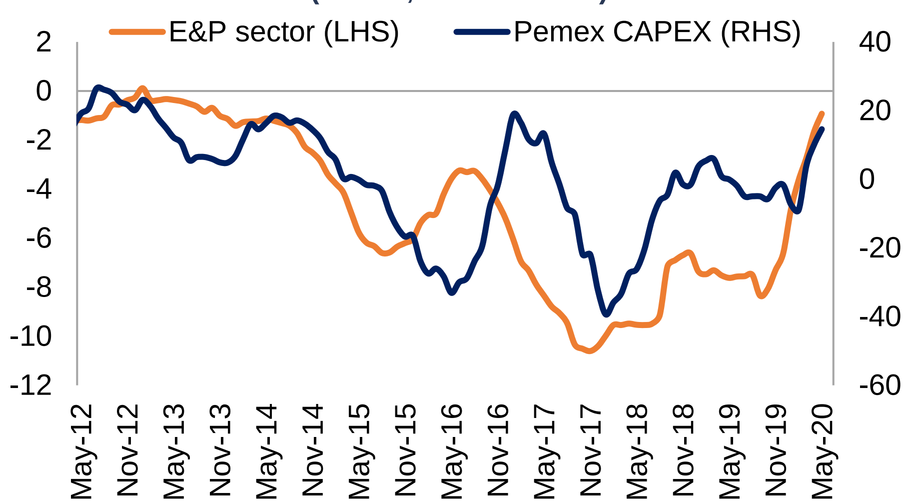
Source: Finamex Economic Research with data from Ministry of Energy.

Figure 6b. Share of oil production sent to refineries (%)



Source: Finamex Economic Research with data from Ministry of Energy.

Figure 7. IP-oil and gas component and Pemex CAPEX (YoY %, 12-month MA)



Source: Finamex Economic Research with data from INEGI and Mexican Ministry of Finance.

Pemex's communication is now focusing on the impact that the oil and gas sector has on overall economic activity. The share of the upstream industry reduced to 3.5% as a share of GDP in 2019, and its sizeable impact concentrates on the IP component (see Figure 7). However, current liquidity restrictions in the company, which imply that resources will firstly be allocated to market debt obligations, reduce the likelihood of diminishing the negative contribution that the oil sector has had on GDP dynamics in recent years. Hence, if the goal to support Pemex endeavors to work as a prospective engine for growth in the recovery period, the chances of a positive outcome in this front are slim.

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