Mexico Unveils Plan to Support State Oil Company Pemex

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New government hopes $5.2 billion rescue package would help stem the state oil company's bleeding

MEXICO CITY—Mexican President Andrés Manuel López Obrador unveiled a $5.2 billion rescue package for Petróleos Mexicanos, which the new government hopes will help stem the state oil company's bleeding and reverse falling output.

"We've taken the decision to support Pemex with everything," he said Friday. "We're going to launch an initial plan, but if they require more, there will be more support."

Economists worry that Pemex's perilous financial condition could be a drag on the federal government and compromise public finances, triggering a downgrade of Mexico's sovereign credit rating and raising the country's financing costs.

In a document circulated to investors Thursday, Pemex said its rescue package had four parts: a capital injection of $1.3 billion shifted from other parts of Mexico's federal budget, a plan to transfer $1.8 billion in funds related to Pemex pension obligations, reducing Pemex's tax burden by $600 million and deploying $1.6 billion in estimated savings from a crackdown on fuel theft.

The latest government support for Pemex means the company won't take on new debt in 2019, Pemex finance chief Alberto Velázquez García said Friday. Pemex had been planning to issue up to $2.8 billion in new debt this year.

Mexico's currency weakened and Pemex bond prices fell in reaction to the announcement. One dollar bought 19.33 pesos around midday Friday, compared with 19.26 the day before, while prices for Pemex's bonds due in 2045 fell about 1% to 87.5 cents on the dollar.

"I think investors had hoped for something more than a Band-Aid," said Denise Prime, co-manager of Swiss investment firm Global Asset Management's $8.5 billion GAM Local Emerging Bond Fund, which invests in Mexican sovereign debt.

The rescue plan "is not going to assuage concerns about Pemex, and probably won't do much to bolster investors' confidence in the quality of government policy," Ms. Prime said. "Things might have to get worse before they get better."

Few economists and energy analysts disagree that the Pemex Mr. López Obrador inherited when he took office Dec. 1 is in dire need of help. With $104.1 billion in debt, Pemex is the world's most indebted oil major, and its production of crude oil has been falling steadily for over a decade as its aging fields become tapped out without being replaced by new, drill-ready finds.

In 2018, Pemex produced an average of 1.83 million barrels of crude oil a day, or 46% less than it produced in 2004. Oil reserves fell by one-third between 2014 and 2018, and natural-gas reserves by nearly half as Pemex steadily cut annual capital expenditures—which fund exploration and production of crude—from $27 billion to $11.1 billion, over the same period.

Fitch Ratings downgraded Pemex's debt to one level above junk last month, citing years of underinvestment in the firm's exploration and production business and saying that outlines of Mr. López Obrador's earlier plan wouldn't be sufficient to turn things around.

Investors have also been spooked by the new president's plans to build a new refinery, and eventually produce most of Mexico's gasoline domestically and halt crude-oil exports. Mr. López Obrador opposes the 2013 legal overhaul that opened Mexico's energy sector to private investment, and has put a freeze on new auctions for drilling rights.

Pemex also has $69.2 billion of unfunded pension liabilities as of the third quarter of last year, a relic of decades of generous benefits packages offered under the firm's collective bargaining agreement.

Economists and analysts worry about where the funds to support Pemex will come from. If savings from the anti-theft efforts fall short of projections, or if reducing the amount Pemex pays in taxes creates a hole in the federal budget, Mexico could forced to borrow money to make up for shortfalls which could harm Mexico's sovereign debt rating.

"The government is walking a difficult tightrope, where further capitalization to Pemex would have to threaten the 1% primary surplus target for the sovereign," said Andrew Stanners, an investment manager at Aberdeen Asset Management. Eating into the planned surplus could "threaten sentiment towards the sovereign," he added.

On Friday, Mexico's finance minister, Carlos Urzúa, said the reduction in Pemex's tax burden would be made up by savings from government-wide austerity measures that Mr. López Obrador has imposed.

"Any private-sector company that had this much debt, this high a labor liability, and this high a tax burden would have gone bankrupt long ago," said Duncan Wood, a researcher who specializes in energy at the Woodrow Wilson International Center for Scholars. "It will be really difficult to right the ship without affecting Mexico's credit rating. If you reduce the fiscal burden on Pemex, that means less money coming into the government's coffers. That's a dilemma in Mexico that goes back decades."

Last year, Pemex paid the government nearly $47 billion in taxes, or roughly 94% of its primary financial balance, a measure of the company's net worth. Pemex ended 2018 with a negative net worth of about $3 billion.

But money alone will not solve Pemex's problems, said Alberto Ramos, chief Latin America economist at Goldman Sachs. That might take dramatic management and strategy changes.

"The new government has an outdated, nationalist view of hydrocarbons— that they're ours, so we have to develop them," Mr. Ramos said. "There's oil in Canada, there's oil in the Middle East, there's oil in dozens of countries in Africa, and there is danger that private investors will pursue those opportunities instead. The risk of the rescue plan is that we may be throwing good money after a bad strategy."

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