It's a gas - no joke

01/04/2000

A $6 billion development program for 190 projects including six major oil refineries is not enough for state oil and gas monopoly Petroleos Mexicanos (Pemex). Emboldened by its economic resilience, Pemex is confident it can also pull off projects to boost limited natural gas production by 2001.

Although the oil commodities market has rebounded and Mexico and Pemex were recently granted credit rating upgrades, both bank and bond market financing in Mexico's energy sector are likely to remain difficult in the coming months because of rising US interest rates. The additional uncertainty of energy sector management under a new administration following presidential elections in July could also dampen successful Mexican oil and gas project financings.

Having weathered recent infamous market storms like the one faced by Comproca in September 1998 ? (the financing for the $1.5 billion Cadereyta oil refinery project which included a $805 million syndicated bank loan as well as a $370 million 12-year Rule 144A bond offering that priced a record 653bp over US Treasuries) ? Pemex officials express confidence in more recent financings like the $1.06 billion nitrogen injection facility at the Cantarell oil fields last August.

Citibank led the Cantarell financing which was sponsored with $437 million in equity from UK-based BOC holdings, Marubeni Corp. of Japan, and Westcoast Energy of Canada, among others. The project had a $623 million debt financing with Jexim open for 60% of the amount and the remainder split by commercial banks.

Jexim provided a $373.8 million direct loan in a 10.5-year tranche priced below Libor plus 100bp. Commercial bank loan financing totalled $249.2 million in two tranches; a $234.4 million A series tranche maturing in 8.5 years and a $14.8 million B series tranche maturing in 10.5 years.

Pricing on the commercial bank loans is the following: A series tranche, for years one to three, 285bp over Libor; years four through five, 310bp over Libor; and for years six to maturity, 340.75bp over Libor. The B series tranche was priced for years one to three at 292.5bp over Libor, years four through five at 317bp over Libor, six through seven 357.5bp and then from years eight to ten at 367.5bp over Libor.

Commercial banks that participated in the syndication were ABN Amro, Bank of Nova Scotia, Citibank, Credit Agricole Indosuez, Deutsche Bank, Export Development Corporation (the Canadian export credit agency), and Fuji Bank.

Other large Pemex projects have had more trouble financing. In December, Deutsche Alex Brown concluded a portion of $500 million floating rate notes for the $1.6 billion Madero oil refinery, that had been pulled out of the market last summer because of a poor market environment just before the Cantarell financing. Prior to Deutsche splitting the notes and selling a $250 million portion last fall, three German banks dropped out of the project: LB Rheinland Pfalz, LB Baden Wuerttemberg, and LB Schleiswig-Holstein. In the end Deutsche was able to raise $322 million. The remaining $178 million uncovered piece ? priced at 400bp over Libor with a tenor of three years, five months ? will be on offer within the next few months according to sources close to the deal.

A month after the Madero floating rate notes closed, Pemex approached the market with a $950 million issuance notes for Pemex Finance, the program the company created in 1998 to fund upstream projects.

Alfredo Marquez, managing director of finance and treasurer at Pemex in Mexico City claims that although investor interest in Pemex Finance offering was strong, the market in mid-February was still difficult. The bond offering which was led by Morgan Stanley, with Goldman Sachs and JP Morgan had to be slightly restructured in order to appeal to investors, explains Marquez.

The notes were originally offered in three tranches but scrapped in favour of two tranches to accommodate investor interest. The offering comprised $150 million in notes insured by MBIA due 2013, priced at 250bp over US Treasuries and yielded 7.8% to investors; and $800 million in notes maturing 2011 priced at 275bp over Treasuries and yielded 9.03%.

To date, Pemex Finance has raised $5 billion that it has invested in Pideiregas ? infrastructure development expenditures approved by the Mexican government and not subject to across the board budget reductions.

Gas development

Natural gas development is a key component in Pemex's growth plan because although Pemex is the sixth largest state-owned oil company in the world, producing an average of $2.8 billion barrels of oil per day, Mexico continues to import gas. The company's overall budget for 2000 is approximately $9.5 billion or 7% greater than 1999 in real terms.

At a conference in Villahermosa, Mexico in February, Rogelio Montemayor, general director of Pemex commented that the company would strive to double its gas output by 2007. Mexico's natural gas production in December,1999, totalled approximately 4.7 billion cubic feet per day.

?Pemex's greatest investment, no doubt, will be aimed at exploration and production in the Cantarell, Burgos, and Delta Grijalva projects, and in addition, we will invest in a strategic gas plan to increase the production of natural gas by around three billion cubic feet per day by 2007,? says Montemayor.

At Standard & Poor's in New York, Boris Segura, associate director, Latin America sovereign debt ratings, asserts that Pemex's insufficient gas production and inadequate amount of private sector participation is a factor that inhibits Mexico and Pemex, from achieving investment grade ratings. S&P raised its long-term foreign currency ratings on Mexico and Pemex just shy of investment grade ? from BB to BB+ with a positive outlook ? a week after upgrades to investment grade -Ba1 from Baa1 ? on the same credits by Moody's Investors Service.

?Despite the fact that Mexico is such an oil powerhouse they're still importing gasoline, even with Pemex Finance and the Pidiregas project. It doesn't make sense at all. Pemex is moving in a positive direction through this Pidiregas instrument but you could say that's not enough,? says Segura. ?We don't expect Pemex to privatize but it should consider opening up to greater private sector investment because the government still doesn't have enough resources to undertake these massive investments.?

New opportunities

Perversely for Pemex, Marquez maintains that since the upgrade issuing debt through the Pemex Finance program has become less attractive. ?With the compression on the spreads that we are seeing after the improvement of the ratings in Mexico, we have more interest in plain Pemex paper then in going through a secured paper like Pemex Finance ? those ratios have also compressed drastically and therefore it makes more sense for us to (capture) Pemex risk,? comments Marquez. The company will not issue any more Pemex Finance paper in 2000.

Marquez adds that Pemex has no plans to refinance any of its projects financed in more difficult market environments in light of the greater liquidity created by the recent rating changes.

Marquez also contends that the steady rise in the US interest rates may offer Pemex opportunities. ?The base reference rates reflect the gradual increases in interest rates in the US. But the ratios that Pemex has to pay when contracting new debt are going down, so the net effect may be positive for Pemex. It really depends on the market opportunities and the market's appetite for new financings,? says Marquez. ?Our overall objectives will remain in place and we will try to maximize ECA fundings.?

Using funds already secured from Pemex Finance offerings, Marquez says this year Pemex will invest approximately $3 billion between upstream operations in the Cantarell and Burgos fields and $625 million in the Delta Grijalva project.

Cantarell, Mexico's largest oil field is located offshore in the southern state of Campache, is clearly the most ambitious project in the entire Pemex portfolio. The multi-year, $18 billion investment program at Cantarell will begin injecting nitrogen into the reservoir this year in order to maintain the pressure and to enhance the recovery ratios.

Critics have questioned the size of the investment saying the nitrogen injection has never been attempted on such a large scale. Cantarell produces Maya crude with associated gas which also being enhanced and used to fuel enormous demands for electricity generation as well as growing industrial consumption in Mexico. The country's state-run electricity company, CFE has announced its intention to increase capacity in Mexico's electricity grid by 13,000 MW over the next six years at a cost of approximately $25 billion.

?The market is growing at 20%. We are trying to catch up with that demand,? comments Marquez. ?It's a very important task for Pemex. We also expect domestic use of natural gas to grow and we will be pursuing smaller exploration natural gas wells in Mexico later this year.?

The associated gas production also coincides with 1997 environmental legislation calling for more natural gas and phasing out of fuel oil in some Mexican industries. Widespread refinery modernizations using delayed cokers greatly improve the quality of the product distillate across the barrel. Mexico's retrofitting on a number of refineries has produced lighter grade crude products and an excess of petroleum coke. Petroleum coke created at the Cadereyta refinery, for example, is being used to fire the 230MW Termoelectrica del Gulfo (TEG I) power project for Cemex, the Mexican Cement maker. Coke fuel is cheaper than gas and gives Pemex an efficient way of disposing of waste in an environmentally sound manner. US-based Sithe and France-based Alstom, the sponsors of TEG I, are also developing the 250MW TEG II plant for Pinoles, using pet coke fuel from the Madero refinery.

Following financing for refinery upgrades at Cadereyta and Madero, in 1998 and 1999, respectively, refinery upgrades at Salamanca and Tula were financed in March.

Paribas led a syndication of a $335 million corporate loan facility which funded both refineries. Tranche A totalling $247 million for both projects was syndicated among commercial banks which included ABN Amro, BDV, BancoMex, Citibank, Fuji Bank, and Toronto Dominion Securities.

Tranche B for $42.3 million is a bridge to a US Exim bank facility. Korea Exim Bank is also providing $54 million in direct loans to the project, while Pemex will make an equity contribution of $2.8 million. The commercial facilities which carry 39-month tenors were priced at 275bp over Libor. Samsung is the EPC contractor on the projects.

Renewed tenders for the remaining refineries to be upgraded ? Minatitlan and Salina Cruz ? are expected after Mexico's presidential election in July. Market observers anticipate the Minatitlan financing will be approximately $1 billion and Salina Cruz's financing to be slightly smaller.

Although Pemex officials will not comment on how either of the leading political parties would influence Pemex, they claim the company will continue its efforts to commercialise its tax regime and decision making process.

With more than one-third of public sector revenues coming from taxes and dividends from Pemex, many analysts doubt any new administration will change the way Pemex operates.