

ENERGY & UTILITIES

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Financier Worldwide canvasses the opinions of leading professionals around the world on the latest trends in energy & utilities.

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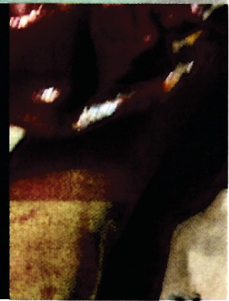
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MEXICO

EDMOND FREDERIC GRIEGER ESCUDERO
VON WOBESER Y SIERRA, S.C.



Q OVER THE LAST 12-18 MONTHS, WHAT MAJOR TRENDS HAVE YOU WITNESSED IN THE ENERGY AND UTILITIES SECTOR IN MEXICO? WHAT RISKS AND CHALLENGES DOES THE INDUSTRY FACE?

GRIEGER: Throughout the past 18 months we have seen remarkable developments in the oil & gas as well as the power sector. Fundamental reforms have turned around the Mexican energy market 180 degrees, allowing private investors to actively participate in most stages of energy sourcing. In the oil & gas sector, we have witnessed mixed results on auctions for exploration and production contracts, whereas in the power sector we are noting a significant increase, mainly within renewables. Both in the midterm are surely going to have positive implications for Mexico's neighbouring markets too. Potential challenges are mainly of a legal nature, as relevant laws and multiple regulations and administrative guidelines, mainly for the power sector, have just been passed and are in the process of being implemented.

Q WHAT PARTICULAR RISKS AND CHALLENGES ARE ENERGY EXECUTIVES FACING IN TODAY'S MARKET? HOW ARE THESE FACTORS IMPACTING BUSINESS ACTIVITIES?

GRIEGER: The Mexican oil & gas industry cannot defy the implications of the current low oil prices, arguably currently the biggest hurdle for those intending to enter the Mexican market. With regard to the legal frameworks surrounding the hydrocarbon sector, Mexico remains a 'frontier region', providing for legal challenges that can be considered a risk for investments. However, at the same time we have witnessed considerable improvements of the provided model contracts by the National Hydrocarbons Commission (CNH) throughout the bids of 'Ronda Uno', which are the public tenders for shallow, deep, ultra-deep water, on shore and non-conventional projects. Regarding the power sector, the 'post-reform' incentives for renewables – Clean Energy Certificates and provided tax cuts – have not yet been seriously tested and it remains unclear whether they actually sufficiently incentivise investments. We will have a better picture once the new wholesale electricity market enters into play on 29 January, and the long term auctions for energy and related products enter into a more mature phase.



Q HOW DO YOU EXPECT THE ENERGY MIX (NUCLEAR, COAL, SHALE GAS, ETC.) TO EVOLVE IN MEXICO OVER THE COMING YEAR?

GRIEGER: Currently, power generation is predominantly based on fossil fuels, with the current estimate at 82 percent. We expect a growth in the renewables, cogeneration and combined cycled generation projects due to the opening market and non-discriminatory regulations. So far we have seen increased interest in solar, wind and cogeneration energy projects. In parallel, we expect new investments into the oil & gas sector in the short term, mainly in conventional exploration and production activities. In the midterm, in refining and post production capacities and, in the long term, potentially in unconventional exploration and production, as Mexico boasts roughly 7.5 percent of the world's shale gas reserves. This will ultimately make hydrocarbons an affordable, hence attractive, energy source.

Q HAVE THERE BEEN ANY NOTABLE ENERGY POLICIES AND REGULATIONS INTRODUCED TO YOUR REGION OVER THE LAST YEAR OR SO?

GRIEGER: Mexico has witnessed tremendous changes in its energy policies, implementing a historic energy reform. Mexico shifted from state owned monopolies to accessible and non-discriminatory open markets in both the oil & gas and the power sector, following examples of established markets. The 'Ley de la Transición Energética' – the Energy Transition Law – was passed by Congress in December 2015 as the last of the reform laws. As a consequence, Mexico is now preparing for the fourth bids on exploration and production of hydrocarbons, which were initiated in mid-2015, and waiting for the first auctions of long-term contracts for power supply.



Q HAVE YOU SEEN AN INCREASE IN RESTRUCTURING INITIATIVES UNDERTAKEN BY ENERGY AND UTILITIES COMPANIES? IF SO, WHAT ARE THE UNDERLYING DRIVERS?

GRIEGER: Since the implementation of the energy reform we have seen an increased extent of restructuring initiatives in the energy sector, as Pemex and the Comisión Federal de Electricidad (CFE) will now have to adapt as competitors to new market conditions with the intensive participation of foreign and national competitors coming from the private sector. Restructuring definitively is playing and will continue to play an important role for Mexico's energy utilities, which need to adapt as public enterprises to survive and excel in the upcoming competitive energy market that has just materialised in the country.

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Q HOW WOULD YOU DESCRIBE M&A ACTIVITY IN THE SECTOR? WHAT FACTORS ARE SPURRING DEALS?

GRIEGER: The Mexican Constitution allows the state now to enter into service contracts, profit sharing contracts, production sharing contracts and licence contracts. So far we have seen licence and production sharing contracts in the first three bids called by the CNH. As Pemex in the so called 'Round 0' has been awarded the most attractive acreages available, we have increasingly seen service contracts and farm outs. We expect a similar effect to the evolving market for private entities and international investors with regard to their exploration and production activities. In the power sector, a similar effect might be triggered by a vehicle called FIBRA-E, comparable to master limited partnerships, requiring assets located and incorporated in Mexico, possibly triggering acquisitions of those assets.

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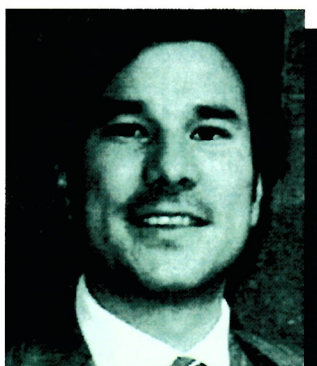
Q WHAT MAJOR DEVELOPMENTS DO YOU EXPECT TO SEE GOING FORWARD? WHAT ISSUES DO YOU BELIEVE WILL SHAPE ENERGY POLICY AND MARKET ACTIVITY IN

GRIEGER: Energy reform is arguably one of the most ambitious legal agendas of the Mexican government in the past decade. In the midterm, it will accelerate economic growth and foreign investments. We are currently witnessing the aforementioned first steps of foreign and national private investors, and we expect those developments to speed up within 2016 and after. As laws have just recently been passed or implemented, their application has not yet been proved. However, the competent authorities, particularly the CNH, have shown the

“Given attractive conditions, national and international investors are keen to enter the Mexican market.”

THE MONTHS AND YEARS
AHEAD?

willingness and an ability to adequately react to investor criticisms expressed within the question and answer procedures within such bids. We are confident that this progress will continue. The huge success of the terrestrial bids has shown that, given attractive conditions, national and international investors are keen to enter the Mexican market. In the power sector, we are seeing significant interest related to the operation of the new electricity wholesale market, as well as with the long term auctions called by the CENACE – the National Energy Control Center – in order to coordinate the offering and acquisition of key electricity generation projects, including renewables.



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