ANALYSING MEXICO'S PROPOSED PETROLEUM FISCAL REGIME

Effectiveness as a Rent Capture Mechanism with the New Energy Reform

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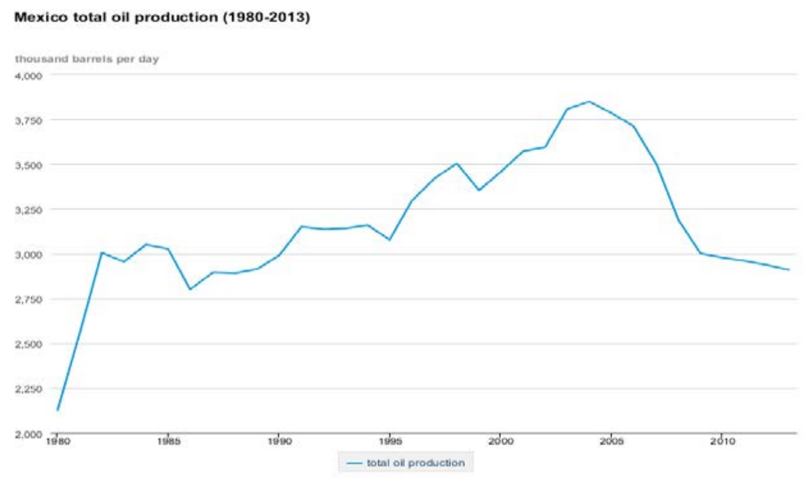
INTRODUCTION

- Mexico's production has steadily declined since 2004.



- Prospective resources to be developed.
- Energy Reform: seeks to help the Nation efficiently develop its resource potential (increase production) and contribute to domestic economy.
  - New contractual terms and fiscal regime
  - First time sector opened to foreign investment since 1938
- April 30th 2014, Secondary Laws were submitted to implement and regulate the constitutional energy reform.
- Optimal fiscal regime: important to capture the most economic rent while avoiding investment disincentives.

OBJECTIVE

To analyse Mexico's proposed fiscal regime (Hydrocarbons Revenue Law), under the licence contracts, considering its effectiveness as a rent capture mechanism

PROPOSED HYDROCARBONS REVENUE LAW

- New method of allocation:
  - Entitlements (Direct Awards) to PEMEX
  - Contracts:
    - Licence contracts;
    - Production-sharing contracts;
    - Profit-sharing contracts; and
    - Service contracts.

DATA & METHODOLOGY

- Representative offshore fields were incorporated: large (500 mmbls), medium (250 mmbls) and small field (50 mmbbls).
- Analysis starting from the field development stage, different costs and phasing profiles were assumed for each field.

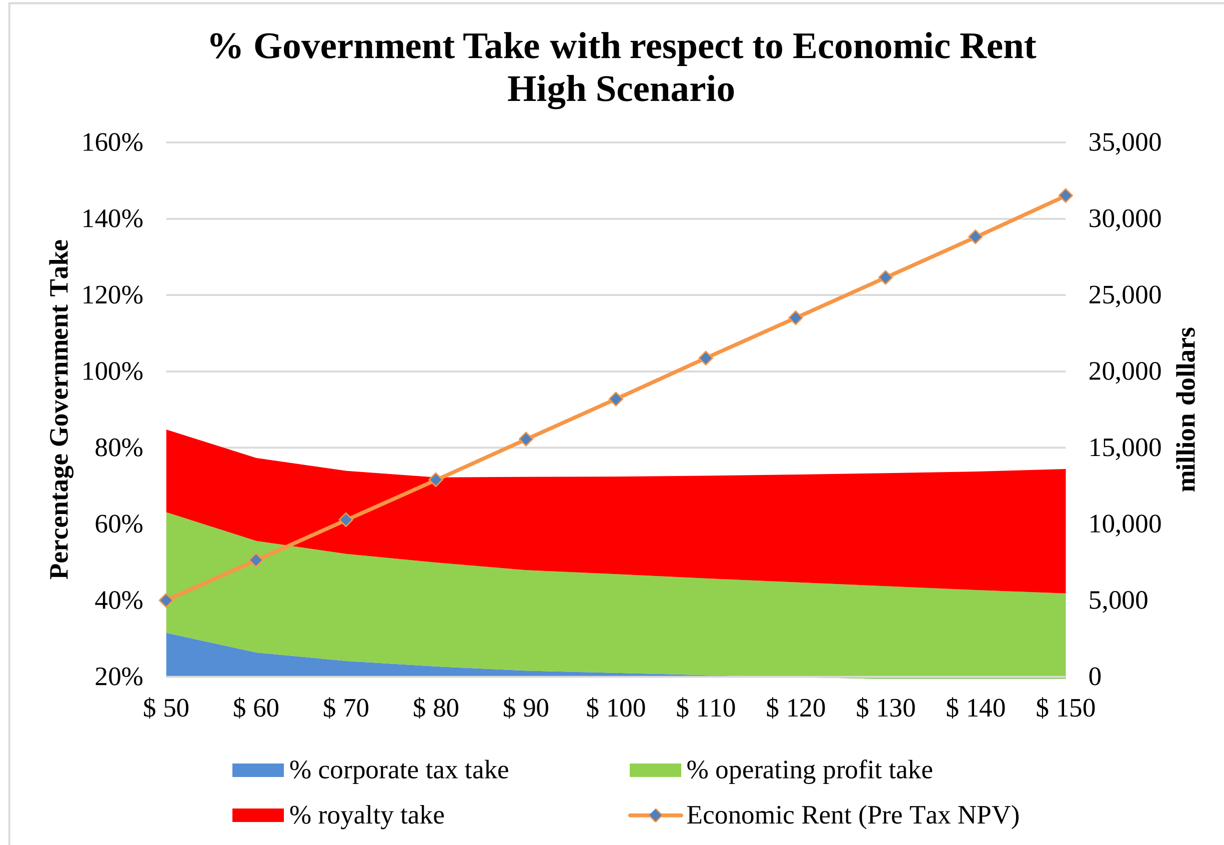
Licence Regime		
Royalty Rate	%	14
Corporate Income Tax Rate	%	30
Depreciation Rate (Straight Line)	%	25
Payment of Operating Profit Rate	%	40
Loss Carry Forward	years	10

- Deterministic cash flow analysis
- Sensitivity analysis
- Monte Carlo simulation

RESULTS

	High	Med	Low
Post Tax Net Cash Flows ($M)	$11,481	$4,677	$1,217
Post Tax NPV ($M)	$5,011	$2,454	$798
Post Tax IRR (%)	48%	46%	85%
Post Tax NPV: CAPEX Ratio	1.03	0.66	0.92
Government Take (%)	72%	71%	62%

- Most sensitive variables; oil price, recoverable reserves, development costs.
- Monte Carlo: Medium field showed greater risk for investor



CONCLUSION

- Proposed fiscal regime is generally progressive; below certain oil prices the effect of mandatory royalty payments make the system regressive.
- Proposed fiscal regime appears to effectively balance front-end royalty payments with the use of tax instruments based on profit without providing disincentives to development.
- Sufficient amount of risk sharing between the state and investors: government collects half of its total expected revenue within approximately 40% of the economic life of the field in all field scenarios.

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