Mexico: North America's last energy frontier is ready to dance

YADULLAH HUSSAIN | November 1, 2014 7:43 AM ET
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If all goes to plan, the country could attract US$350-billion in investments within a decade, according to some estimates. Associated Press

Eagle Ford may be North America's most prolific shale gas basin with more than 8,000 wells drilled in the region. By contrast its Mexican cousin, Burgos basin, just across the border, has barely seen any action. But that may soon change.

In a span of just two years since his 2012 election as Mexican president, Enrique Peña Nieto has swept aside state-owned Petróleos Mexicanos (Pemex) 76-year monopoly over the country's oil and gas sector with a constitutional amendment and a string of new laws.

"The constitution was passed quickly and the secondary laws were passed with blinding speed, and the regulations are being implemented," says Jay Park, a Calgary-based lawyer who has been advising Pemex since 2003. "Everybody I know in the Mexican government is working eighteen-hour days to get this done."

While Mexico and Canada compete to supply heavy oil to U.S. Gulf Coast refineries, some Alberta companies are reportedly eying opportunities across the board in Mexico as North America's last energy frontier opens up.

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Workers guide a section of drill pipe into a rack after it was removed from a natural gas well being drilled in the Eagle Ford shale in Karnes County, Texas, U.S. Mexico has watched with envy the shale oil plays in the United States and Canada, especially Eagle Ford that now yields more than 1.5 million barrels of oil per day. Eddie Seal/Bloomberg

"Mexico is a unique opportunity right now," says Peter Volk, general counsel and secretary at TSX-listed Pacific Rubiales Energy Corp. The company has been targeted by Mexico based-Alfa Group, which has taken a 19% stake in the company in recent weeks in a bid to leverage Pacific Rubiales' expertise in heavy oil.

Mexico has watched with envy the shale oil plays in the United States and Canada, especially the Eagle Ford basin in Texas that now yields more than 1.5 million barrels of oil per day. Meanwhile, only 25 wells have been drilled on the Mexican side, even though the play is expected to contain 60 billion barrels of oil.

"Mexico is a virgin market," says Oscar Lopez, E&Y's Mexico City-based oil and gas leader. "There is opportunity to produce an additional market of the same size as we have today — 2.5 million bpd market."

The International Energy Agency has more subdued projections for Mexico's crude oil output, but that may change as the president pushes through with reforms. If all goes to plan, the country could attract US$350-billion in investments within a decade, according to some estimates.

While there is considerable resistance in Mexico to hang on to the family silver, Pemex is struggling to maintain production and also fund the government's revenues. The company revenues make up 4.7% of Mexico's GDP, and accounts for 30% to 40% of government revenues in taxes.

To appease critics, Mexico's Energy Ministry (SENER) granted Pemex about 83% of the country's proven and probable reserves to exploit on its own — known as the Round Zero allocation — when it announced the historic opening of the sector in August.

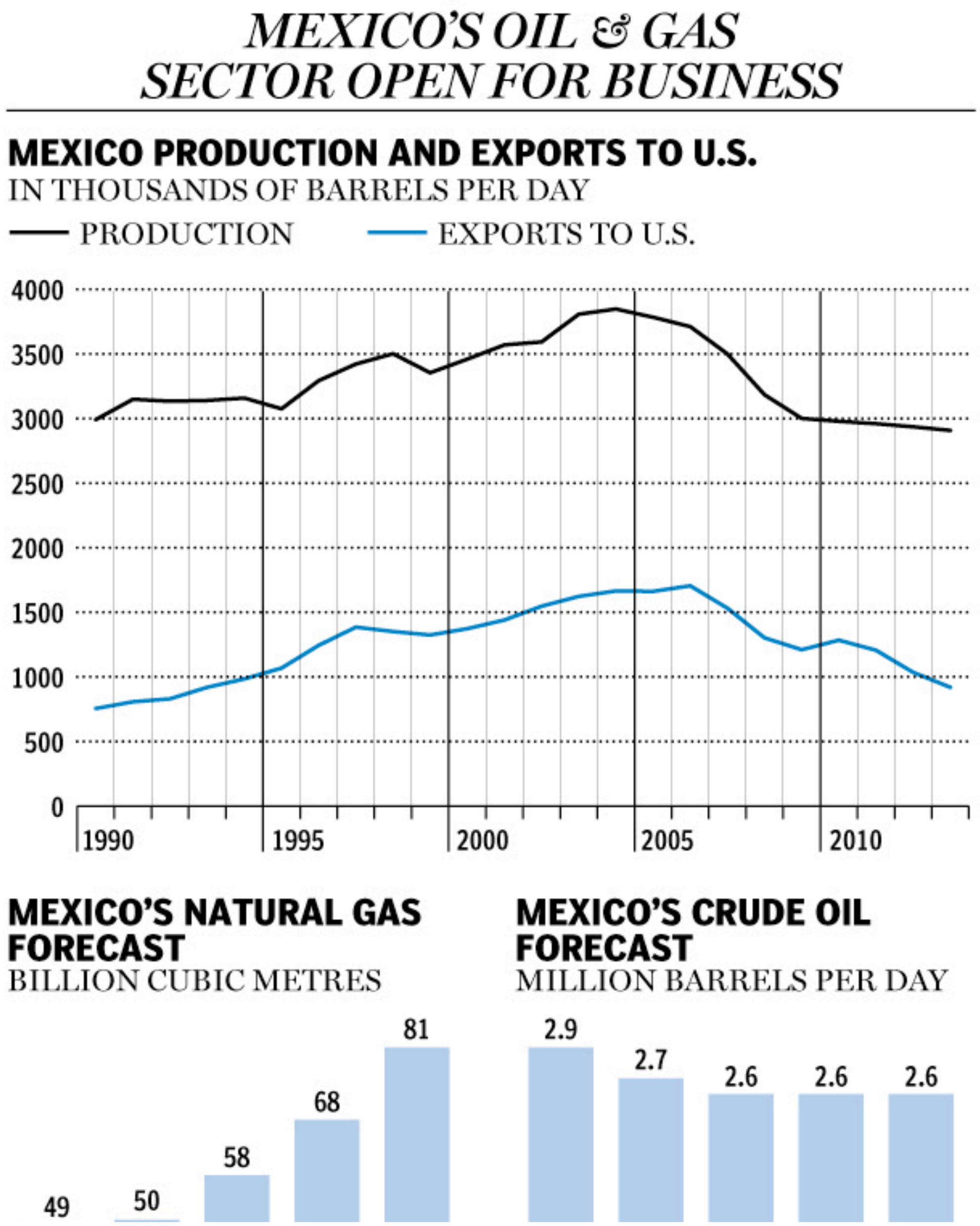
But that's likely to encourage, not dissuade, American and Canadian companies.

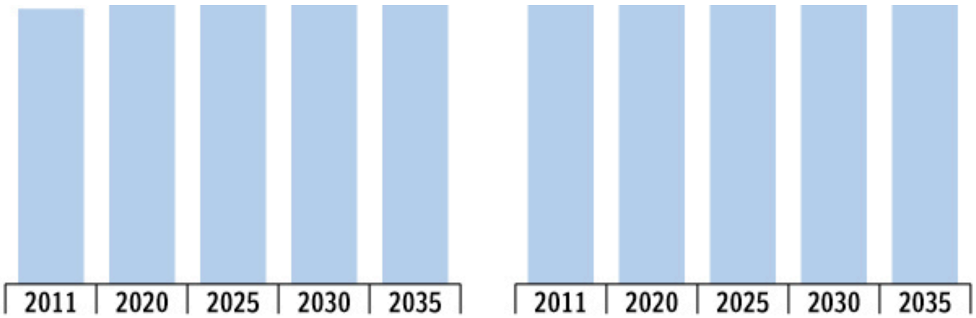
"The biggest opportunity right now is Round Zero," says Eduardo Rodriguez Jr., who founded Calgary-based Flatstone Energy, which advises Canadian clients on Mexican opportunities. "There are a number of opportunities for farm-outs and enhanced oil recovery projects that provide tangible opportunities for Canadian companies."

The overall estimated investment for these projects could reach US$32.3-billion over a five- to 10-year time frame, according to Citibank estimates.

Pacific Rubiales has already taken that route, this month signing a deal with Pemex focused on exploration, deep-water projects, revitalization of mature fields, and heavy and extra-heavy oil.

"We feel that identifying and working with Mexican partners are really the only ways to properly enter the market," Mr Volk said, noting that government-ownership of the oil and gas sector is embedded deep in the Mexican culture.





ROUND ONE OPPORTUNITIES IN MEXICO

Type	Basin	Volume (MMBOE)	Blocks/ Fields
Deepwater	Perdido area	1,591	11
Deepwater South	South	3,222	17
Chicontepec	Tampico-Misantla Basin	2,678	28
Non-Conventional	Tampico-Misantla Basin	8,927	62
On shore, shallow waters	South East Basin	1,104	32
Extra heavy oils	South East Basin	724	11
Non Conventional	Sabinas Basin	142	8

SOURCE: U.S. ENERGY INFORMATION ADMINISTRATION, U.S. DEPARTMENT OF ENERGY, INTERNATIONAL ENERGY AGENCY, SECETARIA DE ENERGIA

JONATHON RIVAIT / NATIONAL POST

The key opportunities are in exploration and production, Mr. Rodriguez says. "It's a bit like a first dance — who will start first, and Pacific Rubiales has taken the lead. Within next 12-24 months, we will see a number of other players going to Mexico."

As part of the opening of the sector, SENER has also rushed to identify 169 production blocs, off and onshore, with total reserves of about 18 billion available for foreign investors in the so-called Round One bidding set for next year.

"All of these assets, though will require significant investment," said Ernst & Young in a report, noting that the initial bid for the first round will likely come in November, with the tendering process starting early next year.
"The accelerated timetable gives companies less time to study the available opportunities, develop a detailed strategy for pursuing Mexican assets and prepare bids."

International companies would also take a long hard look at the new jurisdiction at a time of when shareholders have little patience for marginal projects. But Mr. Park says many of the laws are being based on the "Canadian model" that would appeal to companies.

Canadian companies would also be mindful that their focus in Mexico may hurt them back home, as both countries compete to supply heavy oil to the U.S. Gulf Coast.

Mexican offshore heavy oil is a short tanker ride to the cluster of U.S. Gulf Coast refineries, while Canadian oil has to traverse through environmental opposition, get on barges, rails and choked pipelines across the length of the United States to get to the coast.

While Canadian oil is ascendant in the Gulf Coast in sharp contrast to receding supplies from Mexico, the country could emerge as a threat in future.

"I don't think Mexico is a threat," says EY's Mr. Lopez. "The heavy oil requirements from the U.S. are extremely big. I see North America as an integrated oil-producing area, with Canada and Mexico complementing each other."

For TransCanada Corp., Mexico's infrastructure deficit is clearly an opportunity. The company has US$2.6-billion worth of natural gas investments in Mexico, comprising five pipelines, of which two are under construction.

"The gas infrastructure required in Mexico is growing significantly," said Karl Johannson, president of TransCanada's natural gas business. "Mexico is looking at the North America market and saying they want to be a bigger part of that. So they are building infrastructure from the centre of the country out north and connecting to the greater North American grid."

The Calgary-based company also plans to bid for two power projects with a combined value of $1.5-billion, and is also eyeing opportunities to service the oil sector that may require as much as 15,000 kilometres of new pipelines.

"We have been talking to Pemex over a period of time," Mr. Johannson said. "Right now, 100% of our business is in power and utilities in Mexico, but it's not lost on us that Pemex is a pretty big market as well, and we would love to start doing some business with them."

Security issues are often overplayed as well. "You have to be aware of security and build it into your plan, but it's not something that we found have limited our ability to do business in communities," Mr. Johannson said.

But there is opposition to development from some groups, including labour union leaders that have a vested interest in maintaining the status quo, and that may come to the fore as companies venture out on their own with Pemex's cover.

"My feeling is that there is clearly a divide," said Mr. Rodrigurez. "There is obviously conflict of interest from all the unions. They have a hand in the kitty — some of the union leaders are millionaires and have private jets — they continue to argue that oil is for the people."

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Therefore, don't get your Canadian Christmas expectations too high. In fact, it might be worthy to lower them due to an impending, if not already under way, economic downturn in the oil patch.

With big world economies slowing down, oil prices dropping and fracking oil and gas surpluses exceeding demand, it appears Alberta, Saskatchewan and BC oil field booms have become, at best, stagnant -- meaning the need for new workers is collapsing -- or, at worst, the boom is over, something that has often happened in the past, meaning there will soon be a lot of layoffs. For those to be laid off, that means living on a few hundred dollars weekly rather than big wages, and a corresponding collapse in living standard -- something most, especially among younger workers, will find almost impossible to adjust to.

And it will be even harder on the federal and provincial governments who depend on oil and gas taxes to keep things running smoothly or at least keep deficits down to a manageable level. Bad times have begun.

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