

MEXICO ROUND 1.2 BIDDING – KEY TAKEAWAYS

October 1, 2015

The Mexican government held the second bidding call for five development offshore blocks in the Gulf of Mexico (aka Round 1.2). The results were very encouraging and surprising despite the low commodity price environment and the initial poor results of the inaugural bidding round last July.

We attribute this success to: a) release of the minimum government take ahead of bidding, b) more attractive fiscal terms to work around and, c) more relaxed bidding requirements. We think the government took the right steps to make this round more attractive to investors.

We would like to highlight a few relevant issues to consider for this and future offshore bidding rounds:

1. Bidding Outcome Review:

- **Block 1:** Received participation from all 9 bidders and all bids were well above minimum government take of 34.80%. The average government take for this block was 62.3%. Eni was the winner with 83.75%, or 2.4x the minimum take. This block was closest to the shore and with potential geological reads into onshore fields.
- **Block 2:** Received 5 bids or 56% participation. Again, well above minimum government take of 35.9%. This field is also nearby Pemex infrastructure and a potential read into Tajon onshore field to be auctioned in December 15.
- **Block 3:** No bids. This block had lowest minimum take and was least attractive in terms of geology and crude oil quality. This block was contiguous to 4 of the exploratory blocks auctioned last July (see chart below).
- **Block 4:** Awarded to a consortium with a Mexican startup, Petrobal. This block had Pemex infrastructure around and perhaps the one with greatest "edge" for the Petrobal team who was the only bidder.
- **Block 5:** No bids. This is an indication that minimum government takes should be lowered further to make it attractive for participants given current commodity downturn.

2. Notable NOC/IOC Participation:

The majority of bids were submitted by NOCs (44%), followed by IOC/independents (33%) and the remainder by private equity backed ventures (22%). This large participation of NOC/IOCs can be explained by the high capital and production requirements to qualify in this bidding round. However, we think these blocks should be the domain of the large/mid independents.

3. Increased Private Equity Participation:

The success of Fieldwood Energy and Petrobal is an eye opener for local and international institutional investors that there's an opportunity to allocate private capital into new oil & gas ventures focused on Mexico E&P. Petrobal is a perfect example of how a startup E&P backed by local Mexican entrepreneurs can execute on strategy. In all sense of the words, Petrobal is truly "Mexico's first independent exploration & production company".

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4. State Participation Remains High:

Government minimum take remains high for global standards, particularly when accounting for additional royalties and corporate taxes. Average state participation was 75.92% across all 3 blocks awarded. Block 1 yielded the highest take at 83.75%, followed by Block 4 with 74% and Block 2 with 70%. With this high taxes, for the operators, their bet is an eventual recovery in commodity prices.

5. Minimum Capital Requirements Are Too High:

For this Round, the government's request for at least \$10bn in assets or \$1bn in equity capital along with 15,000 bbl/d of production was an obstacle for many international operators that were ruled out of the process evidenced by the absence of independent E&P that usually participate in these type of offshore development. NOCs bids were notable, however, we think that both Rounds 1.1 and 1.2 should have been the domain of the independents. Minimum capital requirements could be raised even higher for the deepwater round that would rule out the best and most successful independents.

6. Pre-qualification Requirements Remain Tight:

Tight rules for participation forced operators to make decisions in a difficult commodity price environment, the easiest move was not to participate and watch from the sidelines in preparation for deepwater bids. Initially, there were 26 companies that had applied for pre-qualifications, among them large independents and NOC/IOC, however, only 14 showed up to the bidding. Some items that could be improved in this process are: a) extend deadlines for dataroom requests and pre-qualifications and, b) increased flexibility in deadlines to form consortia with financial players, c) more relaxed corporate guarantees.

7. Global Offshore Competition:

For these shallow water blocks, the government still require operators to provide onerous parent company guaranties which could be deal-breaker for many who are still skeptical about Mexico versus other oil provinces that don't require such guarantees thus allowing easier flow of capital into the country (e.g. West Africa countries). For Mexico, with severe above-ground-risks in many onshore regions, offshore activities are still preferred for many participants.

8. Improved Contract Terms:

The government did a timely job at correcting earlier miscalculations in from the inaugural round. Leaders of industry have been very public about the lack of attractiveness of contract terms versus rest of the world. We are in a new oil price environment where "lower for longer" oil prices could be the new benchmark. Mexico needs to compete with other equally, if not more attractive resource provinces in a very difficult environment for the industry that threatens to last longer than expected.

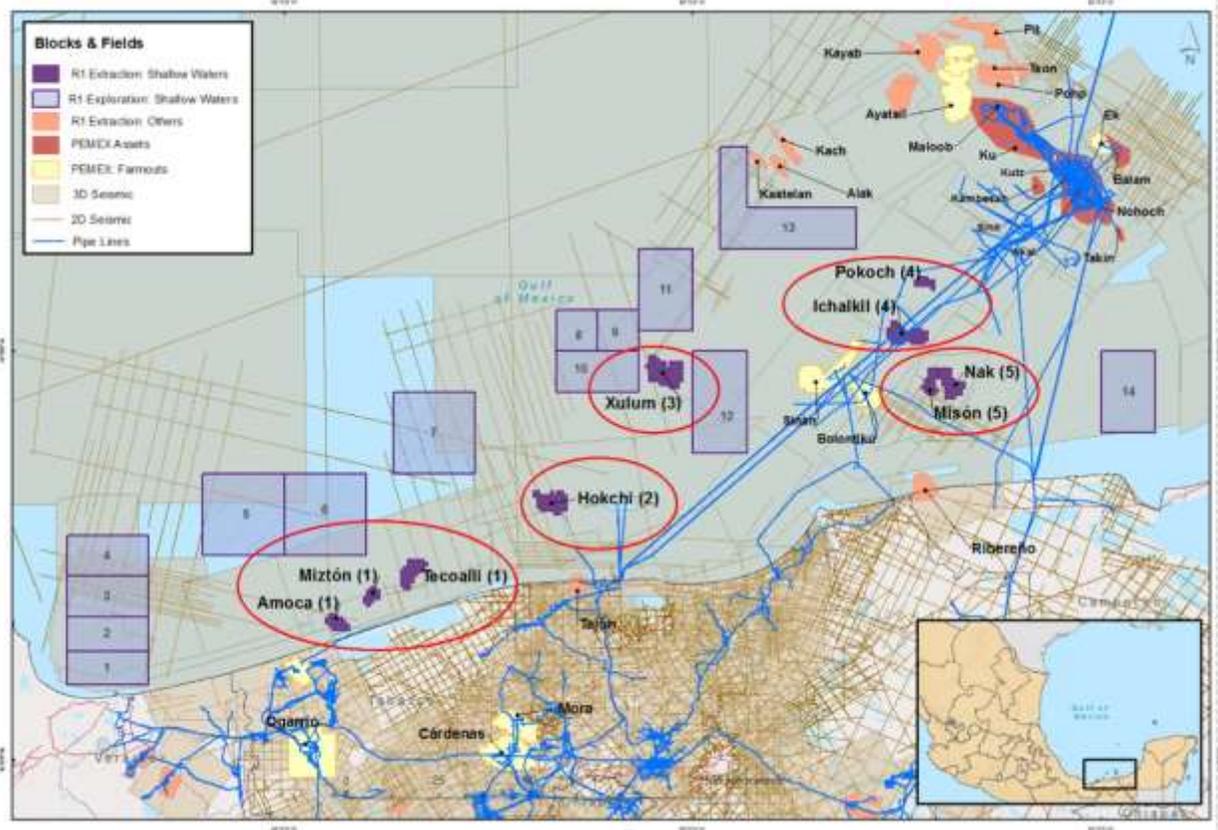
9. Geology/Seismic Data:

Out of the initial 35 companies that purchased the CNH data, only 26 companies seek to pre-qualify, and from those, only 14 submitted bids (or 40% of original 35 interested companies), perhaps signaling that data wasn't a contributing factor. This, however, represents a great opportunity for the seismic contractors (CGG, PGS & TGS among many) who have been working in the country to shoot and reprocess data. Round 2 should be a much better round as more recent, higher quality studies would be available.

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PetroRock Energy

Area Map: First & Second Bid Rounds



Source: CNH

Please reach out with any questions or comments.

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