Oil Wildcatters Head for Mexico

Wildcatters are crossing the border into Mexico to pour money into the country's recently deregulated energy sector, betting that the plunging peso and other economic stress won't disrupt their business.

*By **Robbie Whelan** in Mexico City and **Ryan Dezember** in New York*

VICTOR RUIZ/REUTERS

A Pemex oil platform is seen in 2013. Deregulation of Mexico's energy sector has drawn investment.

Mexico's privatization of its deep-water reserves and onshore fields, which began 18 months ago, represents a new opportunity for energy explorers and investors that have been competing against each other in U.S. and Canadian oil fields for more than a decade.

Riverstone Holdings LLC, a New York-based private-equity firm that is one of the world's largest energy investors, has committed more than $1 billion to Mexican energy ventures over the past two years. That includes funding a pair of companies launched specifically to profit from the sector's privatization—oil explorer Sierra Oil & Gas and **Avant Energy**, which will build and operate pipelines and refineries.

"We're determined to be players here," said Alfredo Marti, a Riverstone managing director who is part of its Mexico-focused team. "We decided that this was a very real, genuine opening involving high-quality assets."

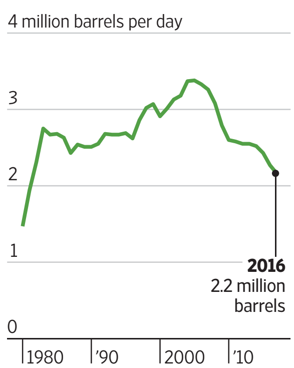
But Mexico's financial markets have been volatile since the U.S. election of Donald Trump, reflecting potential risks that few investors could have anticipated even a year ago. The peso began sliding against the dollar as Mr. Trump's campaign gained traction, and the currency's value, a proxy for Mexico's broader economic prospects, plunged when he was elected president.

Mr. Trump has pledged to renegotiate or pull out of the North American Free Trade Agreement and has pressured U.S. companies such as Ford Motor Co. and Carrier Corp. to scale back or cancel large manufacturing investments in Mexico.

His actions have punished the peso, which has lost about 15% of its value against the dollar since the election and 27% since July 2015 when Mexico held its first auction of oil fields. The currency's decline makes local costs cheaper for companies funded with dollars. Some investment firms, including Riverstone, have raised funds in pesos, and some of their costs, such as leasing drilling rigs, are often invoiced in dollars. So a weak peso makes those costs more expensive.

Slippery Slope

Mexico is privatizing its energy sector as it attempts to reverse declining oil production, which last year fell to its lowest level since 1980.



Source: Petróleos Mexicanos
THE WALL STREET JOURNAL.

Energy investors could also face political risk if a populist backlash grows against Mexican President Enrique Peña Nieto. He made energy deregulation a centerpiece of his economic agenda, but protesters have recently taken to the streets in response to government cuts of gasoline subsidies that are part of the deregulatory measures. That development has some observers worried that the privatization process could stall if Mr. Peña Nieto's party doesn't win the presidency next year.

Mr. Peña Nieto's political opponents "can't stop the process, but it could throw sand in the gears and really slow things down," said Steven Otillar, a Houston-based partner with law firm Akin Gump Strauss Hauer & Feld LLP, who has worked on deals in Mexico's energy industry for two decades. It could "really be bad for business," he added.

A Riverstone spokesman said: "Regarding any potential political risk, our partners are local Mexican pension funds and many of our companies active in Mexico, such as Sierra and Avant, are established in Mexico, staffed by Mexicans and with a Mexican identity, rather than the stereotypical foreign oil interests."

Mexico's oil industry had been a monopoly run by state oil company Petróleos Mexicanos, or Pemex, since 1938. In 2015, Mexico was the world's 12th largest oil producer, according to BP PLC's most recent Statistical Review of Energy.

But Mexico's production has been declining, in part because it lacks the technical ability for deep-water drilling. The country last year produced about 2.16 million barrels a day, its lowest output since 1980, according to Pemex. Mr. Peña Nieto in 2013 signed laws intended to modernize the industry by opening up the sector to foreign partners and their expertise.

Riverstone has raised more than $34 billion from investors since 2002, notching big profits investing in pipeline operators and U.S. shale explorers. The recent oil-price slump reduced the value of many of its holdings, though lately the firm has posted big gains buying and selling West Texas oil fields.

Jason Marczak, a Mexico expert with the Atlantic Council, a nonpartisan Washington think tank, described wildcatters like the companies backed by Riverstone as a kind of "first line" of investors in what amounts to an untested process of privatization.

Riverstone, along with Houston-based investment firm EnCap Investments LP and a Mexican unit of BlackRock Inc., have collectively invested $525 million in Sierra, which is based in Mexico City and was part of a bidding group that in December won rights to explore a deep-water block. That month Riverstone also committed another $300 million to Avant, which is also based in Mexico City and plans to focus on oil and gas distribution and processing.