

The informed optimist

INTERVIEW WITH DR JUAN JOSÉ SUÁREZ COPPEL

DIRECTOR GENERAL, PETRÓLEOS MEXICANOS (PEMEX)



JUAN JOSÉ SUÁREZ COPPEL

holds a doctorate in economics from the University of Chicago and has held various important positions in the public arena, as well as in the private and academic sectors. He served as Chief of Staff to the Secretary of Finance and Public Credit Francisco Gil Díaz and was Chief Financial Officer of PEMEX from 2001-2007. A former Treasurer of Televisa and Vice President of Finance at Grupo Modelo, Dr Suárez Coppel has also lectured in economics at ITAM in Mexico, the Autonomous University of Barcelona in Spain and Brown University in the US.

It's been six months since you took over as Director General of PEMEX with a mandate from President Calderón to effect a root-and-branch transformation of the company. How would you describe your progress so far, and what are your key objectives for your first year in office?

I would say that progress has been mixed. In terms of the most important parts of the business – crude oil production and reserve replacement – I would say that I am comfortable with the situation. It is better than I expected when I arrived and I understand now what are the key issues that we have to act on as soon as possible, so the agenda has been shaping up well and I'm happy about that.

What I'm uncomfortable with and unhappy about – although it doesn't surprise me – is how long it has taken us to 'get our hands dirty' and to arrive at a point where we can start actually making a difference. PEMEX is a huge organisation, and like an aircraft carrier or a super-tanker, it is very hard to turn around.

We have a football saying here in Mexico that 'a goalie without luck is not a goalie', and I feel fortunate that the most critical issues that we need to fix are fixable in the short to medium term, because three years is nothing in terms of new projects. Thankfully, we don't need those in order to get the results that we need – we have plenty of 'low-hanging fruit' to go for in the meantime.

By what benchmarks will you judge the success of your efforts over the next three years?

I believe that we, as Mexicans, should expect PEMEX to be one of the top-tier national oil companies in the world. Of course, that has to be measured and defined, but I think that's what our vision should be. For me personally, the benchmarks will be in terms of improving crude oil and gas production, reserve replacement, and security of supply – those are our key mandates. And then, of course, the company has to become profitable. That, in a nutshell, is what I believe our goals should be.

Turning around a 'super-tanker' like PEMEX is clearly a manoeuvre that can't be executed by the captain alone. How is your 'crew' shaping up and who do you have in mind for the key positions?

It's shaping up fine, given that PEMEX is more of a government agency than a true company in terms of

its behaviour. It's not easy to get new people into it but fortunately PEMEX has a lot of very experienced and very valuable people in it already.

This is my second stint in PEMEX – I was here for six years as Chief Financial Officer, up until three years ago – so when I came back as Director General, I pretty much knew everybody in the leadership team. That means that we share a detailed knowledge of the background of this company and know what needs to be done, but we also share a deep sense of frustration at not being able to make PEMEX fulfil its role.

If you think of PEMEX as a black box into which you put a lot of potential hydrocarbon resources, a lot of people with experience and love for the company, and a great deal of investment – as we have – you should be getting out of it an awful lot more money, oil and new reserves than we are. And that's the challenge: we need to instill a greater sense of responsibility, accountability and flexibility in order to be able to create our own destiny as an organisation.

One of the most admired national oil companies in the world is Saudi Aramco, and in Saudi Arabia they have the same constitution as we do. So, you don't need to change your constitution to have an administration that performs, that is able to do its job, and that creates a lot of value for the owners of the resource, that is to say the citizens of the country.

For me, the critical thing is changing the way that we work and for that you need a leadership team that believes in what you're doing, that shares your goals and has a clear sense of urgency. It has taken us a while to get the right team in place and it's still evolving because the process of change is ongoing, but one thing I'm clear about is that if we don't perform, other changes will need to be made – starting with me.

You probably know the company's finances as well as anybody. How would you describe the current financial position of the company?

Well, our current financial situation is troublesome, to say the least. We have negative net worth, our downstream has been losing money hand over fist, our production has been falling for the last five or six years and we haven't been able to replace our reserves 100 per cent. But as I said before, I think that if we do several practical things that are do-able, and they are do-able in the current circumstances and within the

current regulation, we can start turning around the numbers of the company.

How sympathetic is the government to the need for PEMEX to retain and reinvest more of its earnings, rather than simply handing the bulk of its revenues to the Treasury?

I am optimistic because I feel that we are in a potential win-win situation in which PEMEX can grow, and by growing can generate more fiscal income and also equity income for the government. Provided we are able to get a few quick wins, we should be able to get more breathing space in terms of pushing for further changes and ultimately make the pie bigger, so that even though we have to provide a significant amount of taxes these taxes are not eating the whole pie, thereby leaving us a bigger 'slice' to invest and operate.

You don't make a Sumo wrestler fitter by hacking chunks off him with an axe – you simply end up with a fat guy with no legs. You need to invest in proper eating habits, training and so on, cutting out the excess fat so he can emerge leaner and stronger at the end of it.

What kind of 'diet' are you putting PEMEX on?

The diet has to do with getting the proper capabilities. When you are responsible for an organisation like PEMEX you have to identify the core capabilities that you need in order to develop, and invest in them. In doing so you start growing the business.

It's simply a matter of getting enough technical knowledge and management ability, and then re-engineering your business processes so that all these things that go in your black box give you the proper results.

The oil industry is peculiar in the sense that you need to collaborate not only with your providers and your clients but also with your competitors. The technological and geological issues are such that you will always have to be open to get the best ideas, and through collaboration you attract these ideas and attract the people and capabilities to develop what you have, and find the win-win situations where that collaboration is most successful. What we are doing in Chicontepec, for

example, is looking to have a deeper interaction with our service companies so that we can make use of their experience and their understanding of similar fields where they have worked in the past, and work together in field laboratories to find the right technological concepts to get a higher level of productivity out of our wells – and our investment.

What we're trying to do is to give PEMEX a broader execution capability but also to gain knowledge of different ideas, techniques and technology so that we can have a successful development plan for Chicontepec. Having done that we can then think in terms of replicating it and investing more in developing the whole field. The same thing applies in the case of deep water; we are in charge of developing the resource, we are not looking for somebody else to develop the resource for us. What we are looking for are partners with whom we can collaborate in order to develop our own capability in this area.

Do you think the proposed 'incentivised contracts' will prove sufficiently competitive to attract the sort of collaborators that you're looking for?

We believe that the contracts that we have available now are sufficient for us to start getting that collaboration. That is what the oil companies are telling us. Are they the best contracts available? No, but they are certainly of value and we are confident that they will produce the desired results.

At the end of the day, our constitution defines how the oil and gas industry in Mexico has to develop and the change in the law was very specific in stating that PEMEX is to remain at the centre of the development of the industry. So, if we bring in capabilities and we in bring execution and so on it has to be through PEMEX, although of course that means

PEMEX has to do its job, which means developing the capabilities to develop our own

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Pumping up the volume: PEMEX intends to produce an average of 2.5 million barrels a day in 2010

resources. I think that these contracts are going to take us a long way towards achieving our objective, which is to have PEMEX collaborate and develop the expertise to go forward.

Do you ever look at Petrobras – a national oil company that has partnerships with international companies both at home and abroad but remains quintessentially Brazilian – and think ‘why don’t we do that?’

PEMEX is a company and as such, the less restriction it has in terms of contracting or acting or investing, the better. Sure, I would love not to have all these restrictions because I feel we could create much more value without them. How much sense does it make for a company to have their budget decisions taken by stakeholders that don’t have direct ownership of the company and don’t have direct responsibility in terms of the returns or the consequences of that budget allocation? It doesn’t. I feel that as we progress in terms of communicating the issues, getting that vision across of what is required in order to have a strong PEMEX, that these changes will occur over time, but for that to happen you have to go for the quick wins and build from there.

A lot of the things that we are doing right now would have been unthinkable without the changes in the law in respect of PEMEX, or the energy sector reform. I think we tend to play down what these changes did but they were very important, critical even, because they not only gave us the flexibility to contract but also created a clear mandate of what the company is about, and what the law says is that this company is about creating value for the country. That mandate wasn’t there before and it’s very powerful. And it created a corporate structure that will allow us to create that

value and make the changes that we need to make in order to do it.

Right now we’ve got the flexibility to contract specific services or inputs for the production of oil, but other things are not possible for the company because we still have to go through the old legislation. If we all agree that the way we were contracting before is inefficient, and if we can prove that our corporate governance and checks and balances work, then the first thing we should do is go back and get rid of the rest of the restrictions in terms of contracting, and so on. Once you have the corporate governance in place you prove the corporate governance concept and make sure that it works, then you can go on to make even more changes.

But as you say, these things take time and time is something of a luxury for Mexico given the scale of decline in production from the Cantarell field. Are you not going to have a ‘crunch’ in a few years’ time in terms of the country’s fiscal situation?

I think that the combination of bringing in new technology, through our collaboration with other companies within the current contracting situation, bringing in greater operating discipline and gaining flexibility over time, will enable us to realise a lot of the potential that exists in our mature fields. There’s a lot of potential in our existing shallow waters and inland fields, there’s a lot of potential in Chicontepec, as we proved, and again as we make the changes that we need to do, we create more room for changing the framework within which PEMEX works, and then more changes will come about and better results will ensue. I don’t underestimate the scale of the challenges we face but the sky is not falling on our heads.

So, would you say you’re a ‘glass (or barrel) half full’ man rather than a ‘glass half empty’ one? What are your projected production figures for the remainder of this year?

I prefer to think of myself as an informed optimist. It’s a tough journey ahead but I remain cautiously optimistic that in three years’ time we will have achieved a lot of the things we set out to do. I haven’t given you many figures today because I think it’s time for PEMEX to under-promise and over-achieve, but I can tell you that our production projection for this year is 2.5 million barrels per day, and we are very comfortable with that figure. I hope that within a year we’ll have a better idea of what is an attainable or sustainable plateau for production in the future. I think that again as we prove the concepts in our field laboratories then we will be able to have a better idea of what the plateau is for Chicontepec and at what prices we should attain that plateau over a three years stairwell.



Having been here only six months, I'm still not comfortable giving out figures that I'm not sure we can meet, and the only figure that I can give you right now is the 2.5 million barrels a day.

What is the current status of the Bicentenario refinery project? Where do you expect the estimated US\$ 9 billion to build it to come from, and will its location in Tula [in Hidalgo, a PRI-controlled state] give the President the political capital to effect other reforms that might be necessary to achieve your objectives?

We are currently in the engineering phase; we already hired a technologist and we are now moving from the concept to the basic engineering. These are the stages where you create value for a project – you cannot rush these processes and we're taking no more or less time than we need in order to have a successful project.

When Pemex has tried to rush through these stages in the past we have had horrible results, and we don't want another one with such an important project.

We feel that it would be a big mistake to politicize where we build this or any other project, whether it be upstream or downstream. What we're trying to do at the moment is to create value for the company, and that's how we are approaching the project.

Do you think it will be sufficient to reverse the growth in imports of refined petroleum products that we've seen in the last few years?

I don't think that is what should worry us the most. Our mandate is to make sure that we have a secure supply of products, together with our mandate to create value. Building Tula makes sense because of the amounts that we need, not just now but also in the future. On the other hand, you have a situation right now in which there is excess refining capacity in the world, especially in North America on the Gulf Coast but also in Europe, particularly in gasoline, so we need to take that into consideration when trying to create a secure supply for Mexico in the future.

We're looking to invest heavily in our refinery system in Tula with new capacity but also modernising Tula, Salamanca and Salina Cruz, modernising our entire logistical system in refining. In 2008 we lost 120,000 million pesos, that's about 9 billion dollars, in our downstream business. We also lost about 20,000 million pesos in petrochemicals, that's another 1.6 billion. This year we are going to be funding a 18.5-19 billion dollar Capex programme and we need net indebtedness. We have to raise around 9.8 billion dollars in debt but we are close to 6 billion of that through re-financing. The point is that we are raising close to 4 billion dollars of debt in order to invest our 19 billion. If we were not losing the amount of money that we have been

losing downstream, we could fund our entire Capex programme without going to the capital markets – or we could increase sizeably our Capex programme with manageable amounts of capital. That's what we have to keep a focus on. But the upstream cannot carry downstream in an institution like Pemex.

What we need to do first and foremost is to have a strong company in terms of its execution capabilities and in terms of its financial strength, so if it makes sense and it creates value for Mexico to have a given gap of imported products under secure, long-term contracts at prices that make sense, that will enable to use and invest our resources where they are more productive for the country.

Mexico has vast gas potential, yet the country continues to import the fuel in ever-greater quantities. What is your strategy for realising that potential and thereby reducing Mexico's dependence on imports?

It's the same as with crude. What we need to do is to make sure that we have the resources, the technology and invest the Capex and execution capabilities to develop that gas. We have been very successful in Burgos; we were very successful in the last couple of years in Vera Cruz, where what we have identified in deep water is mainly gas so far, and we are going to start drilling our first shale gas well just across the border from the US very shortly. We have identified several locations in the country where there are significant gas reserves, we just need to make sure that we have the execution capability, the technical expertise and focus our resources in the right place and the gas will come. As you said, we know the gas is there and there is no reason why we cannot get PEMEX and its partners to develop that gas within our present legal system. ■

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PEMEX Director General Juan José Suárez Coppel in conversation with Alastair Harris, Executive Publisher and Editor of World Petroleum

