THE MEXICAN RETAIL FUELS REVOLUTION

OIL DEREGULATION OPENS DOOR FOR NEW FUELS MARKETERS AND RETAILERS IN 2016 AND BEYOND

Bob Orr • Karina Swette

As Mexico deregulates its oil industry, it is opening its doors to the largest fuels marketing and retail prospect on the horizon.

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The percentage by which Mexican pump prices exceed those in the United States

For the first time, foreign companies will be allowed to own and operate fuel assets, and companies will be able to import and sell fuel that is branded and sold by suppliers other than Pemex, Mexico's state-owned petroleum company. New fuel marketers and retail offerings will change the market landscape and shake up the legacy industry.

A highly attractive market, Mexico is the sixth-largest consumer of motor gasoline and diesel, with consumption forecasted to grow by around 3 percent annually, roughly double global demand. Mexican fuel site throughput, the average amount of fuel sold per retail location, is 30 percent higher than other, mature markets. Average fuel prices in Mexico are currently almost 50 percent higher than in the United States. And only about half of Mexican fuel stations have convenience stores, compared with 80 percent in other countries.

Most deregulation talk focuses on oil exploration and production, but as the Mexican market opens, investors who are willing to work through the challenges of the evolving market will discover enormous opportunities downstream. (See Exhibit 1.)

ATTRACTIVE MARKET DYNAMICS

Mexico is one of the last developing markets to deregulate. Its size, current pricing arbitrage, high site throughputs, fragmentation and limited customer offerings make it attractive for incumbents and new competitors who invest in new retail fuel offerings.

Mexicans consume more than 750,000 barrels of gasoline per day, and demand is expected to grow twice as fast as global demand and at a higher rate than the top five fuel consuming nations. Such demand growth will likely lead to an increasing reliance on imports. With oil prices in the US dropping, US refiners that have access to cheap crude will continue to increase fuels exports, and Mexico is their closest and largest import market. Imports already account for 48 percent of Mexican fuel consumption and are projected by Oliver Wyman to reach up to 60 percent of total consumption in 2020.

The Mexican government sets fuel prices and has steadily increased prices over time. Historically, this meant the Mexican government was subsidizing fuel prices. Throughout 2008, 2011 and 2012, the equivalent gallon of Pemex Magna in Mexico was often $0.75 to $1.25 cheaper, as US prices exceeded $3.50 a gallon. But with the recent drop in global crude prices, the price per gallon in the US has declined to $2.00, on average, while the steadily increasing price in Mexico now exceeds $3.00 per gallon. That's 50 percent higher and creates significant arbitrage opportunities.

The number of retail fuel stations in Mexico is controlled by the government and stands at just over 10,000 sites. As demand has increased without a parallel growth in the

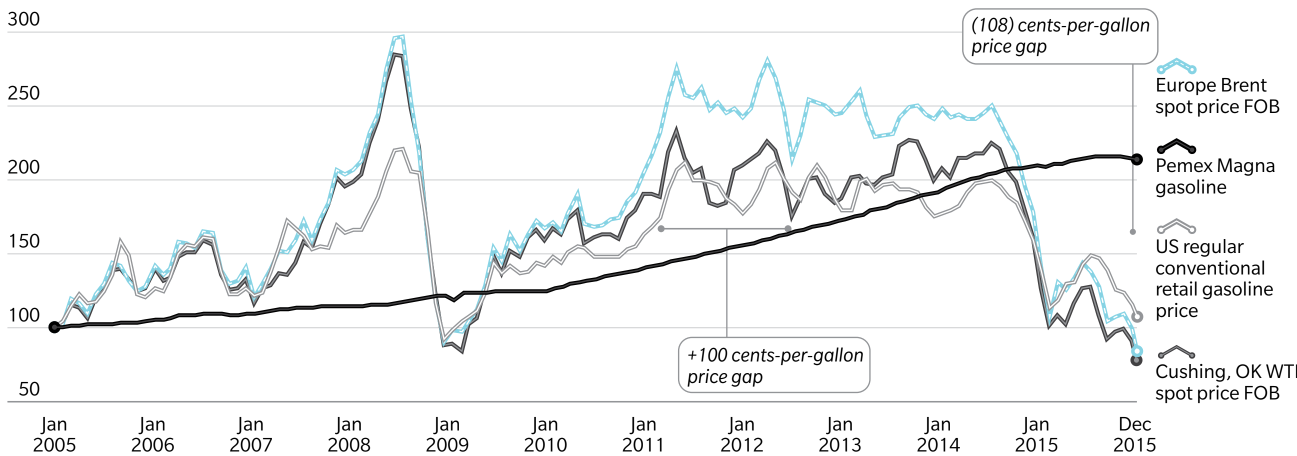
EXHIBIT 1: MEXICO REFUELS

Mexico's deregulation of its oil and gas industry is creating huge fuels marketing and retail prospects for foreign investors that could fundamentally change the way Mexicans buy gasoline and diesel

MEXICO FUEL PRICE GAP

The regulated Mexican gasoline price has created a wide profit margin for foreign suppliers...

INDEXED, 2005–2015 (2005 = 100)

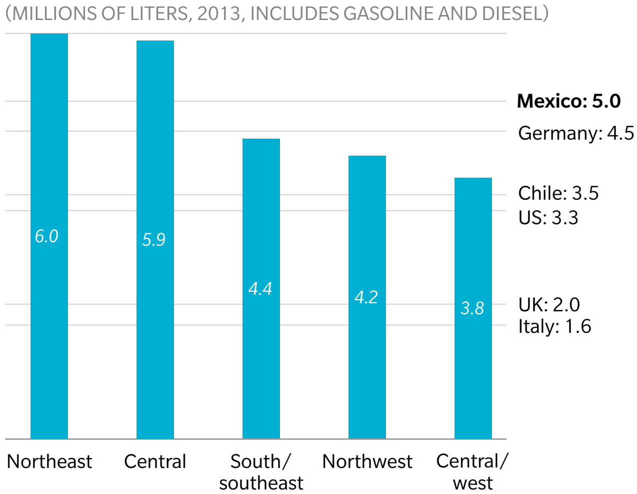


Source: Pemex Magna unleaded (regular), Energy Information Administration; Oliver Wyman analysis

HIGH SALES VS. OTHER COUNTRIES

...plus, Mexican service stations sell more fuel per station than those in other countries...

AVERAGE ANNUAL CONSUMPTION PER REGION OF MEXICO AND THROUGHPUT
(MILLIONS OF LITERS, 2013, INCLUDES GASOLINE AND DIESEL)

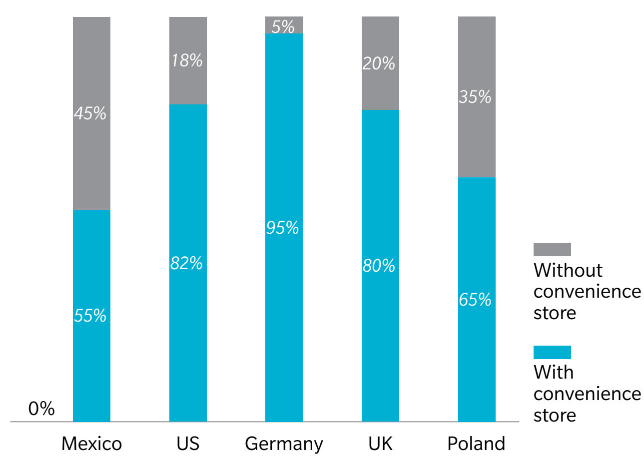


Note: UK excludes supermarkets in average
Source: Country government reports, Oliver Wyman analysis

FEWER CONVENIENCE STORES

...and there is a lower percentage of gasoline stations with convenience stores

CONVENIENCE STORES PENETRATION IN GAS STATIONS
(PERCENTAGE OF STATIONS WITH CONVENIENCE STORES)



Source: CBRE – Market View European Petroleum Retail Sector, US Census Bureau; Oliver Wyman analysis number of stations, Mexico now has one of the highest average volume throughputs per station in the region and globally, at 5 million liters per station. The average throughputs in larger Mexican markets, including Mexico City, are more than 6 million liters per station, 50 percent higher than average neighboring US regions, creating attractive site-level economics. In addition, several of these Mexican regional markets use exclusively imported fuel products, compounding the tension in supply-demand dynamics and driving a potential structural change.

With only Pemex branded fuel and stations allowed in Mexico until this year (2016), the competition and investment has been much more limited than in other markets. Additionally, Mexico is a highly fragmented market with more than 5,000 franchisees operating only one or two sites, making organic improvement in offerings challenging. This has left the consumer offering relatively limited. There are fewer non-fuel services than in similar markets (only half the sites have convenience stores), and many facilities lack the cleanliness and security desired by consumers. Even the largest franchisees operate fewer than 300 stations, making scale operations a challenge.

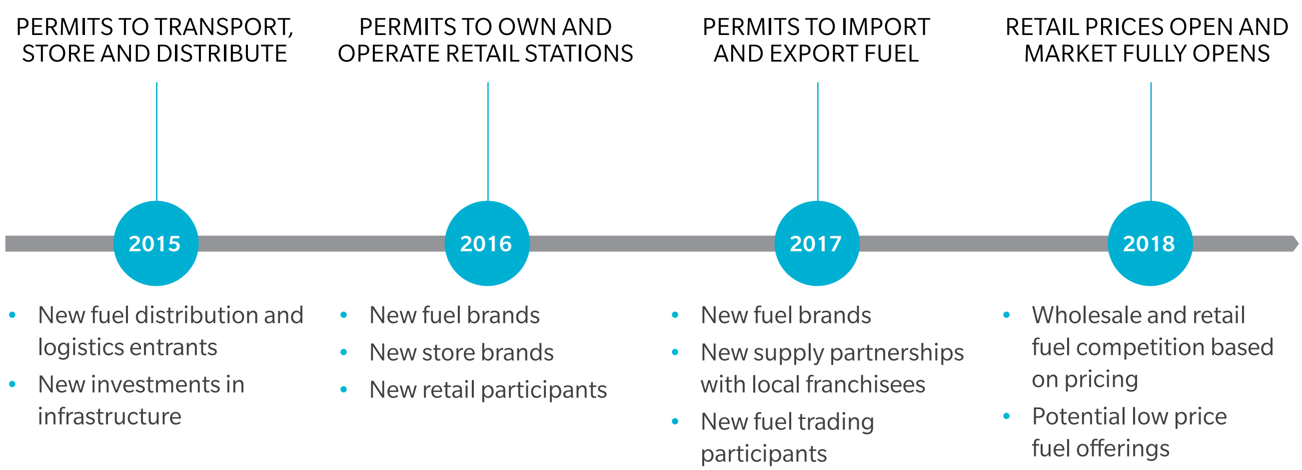
But that has not restricted the development of grass-roots efforts to meet consumer demand. The largest franchisees have developed their own offerings (including loyalty programs, fleet cards and fresh food,) proof that the Mexican consumer is looking for expanded choices.

REGULATORY CHANGES

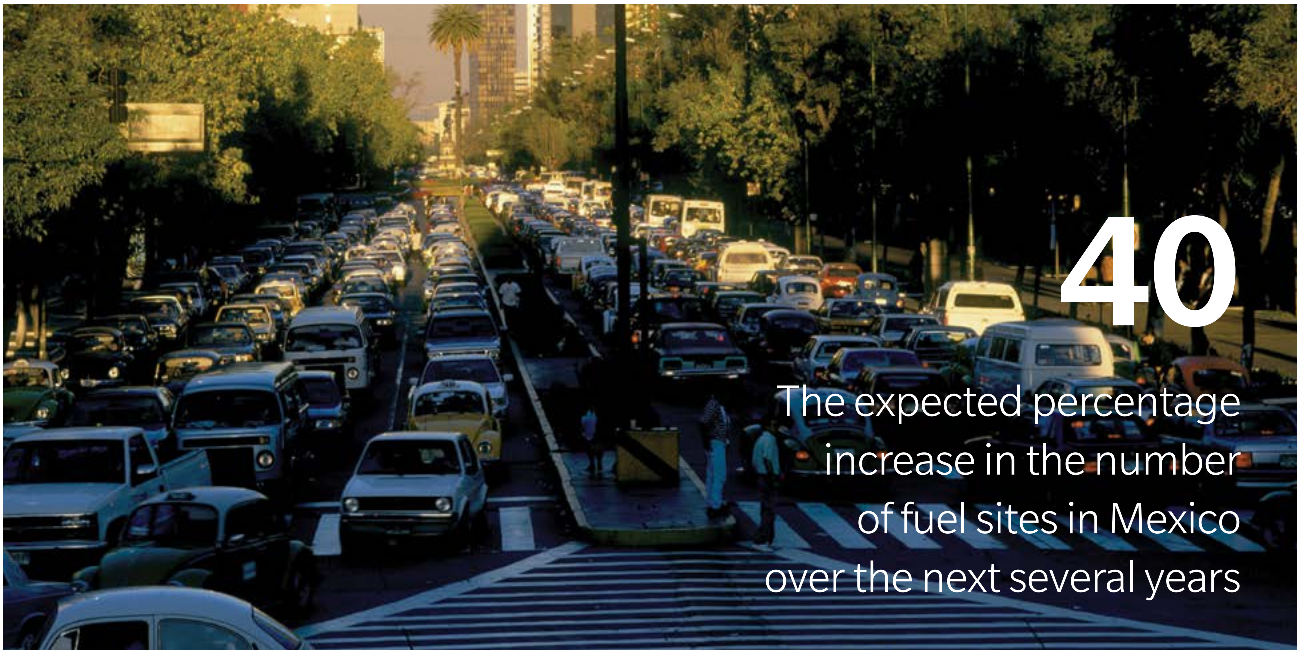
Deregulation laws passed in 2013 and 2014, and Mexican regulators are implementing plans to relax control of the market in the next few years, impacting all areas of energy. The regulatory changes are occurring in phases. Permits to transport, store and distribute fuels were offered in 2015. The government plans to offer permits to own and operate retail stations in 2016, with fuel import and export permits to follow in 2017. By 2018, retail prices open and the market fully deregulates. (See Exhibit 2.)

EXHIBIT 2: MEXICAN DEREGULATION TIMELINE

Foreign investors are in a strong position as Mexico follows a plan to full deregulation



Source: Pemex and Oliver Wyman analysis



Investing in the Mexican fuels market, however, comes with risk. Several details about the regulations are not clear, such as exactly how and when permits will be awarded, if foreign companies will be allowed to buy existing assets and how the number of retail stores will be regulated. Further, it is not clear how regulators will determine fuel prices during the transition period or how prices will change. It is essential for participants and investors to monitor the changes closely and develop flexible strategies.

EVOLVING DYNAMICS

Market dynamics will continue to evolve, with consolidation of current players and new sites and concepts from market entrants. Existing local fuels and convenience retailers will continue to grow and consolidate, with larger companies speeding up the pace of buying smaller operators. New entrants and local participants will build new fuel sites and probably test hypermarket and grocery fueling offers. In this fertile environment, the number of fuel sites could grow in the next few years by more than 40 percent.

A range of foreign refiners, midstream operators, fuel distributors, marketers and retailers will build, buy and form partnerships, bringing new value propositions and offerings in fuel and convenience. A large, attractive market lacking in customer choice, Mexico is about to undergo a deregulation revolution that will fundamentally change the way consumers get their fuels.

BOB ORR
is a Houston-based partner in Oliver Wyman's Energy practice.

KARINA SWETTE
is a Houston-based principal in Oliver Wyman's Energy practice.