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Research Update:

Ecopetrol 'BBB' Ratings Affirmed Despite Weaker Financial Risk Profile And Liquidity Assessments, Outlook Still Stable

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Table Of Contents

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Overview

- We are revising our financial risk profile assessment on Colombia-based national oil company Ecopetrol to "significant" from "intermediate" because we expect its credit metrics to weaken due to declining oil prices.
- We are also revising our liquidity assessment on Ecopetrol to "adequate" from "strong" based on our expectation that the company will maintain aggressive capital expenditures and dividend distributions despite lower operating cash flow generation.
- We are affirming our ratings on the company, including our 'BBB' long-term corporate credit rating. The 'bbb-' stand-alone credit profile remains unchanged.
- The stable outlook reflects our view that Ecopetrol will continue to play a very important role in the Colombian economy and maintain its very strong links with the government.

Rating Action

On Feb. 26, 2015 Standard & Poor's Ratings Services affirmed its 'BBB' long-term corporate credit rating on Ecopetrol S.A. At the same time, we affirmed our 'BBB' senior unsecured rating on the company. The outlook on the corporate credit rating remains stable.

Rationale

The rating on Ecopetrol is based on its stand-alone credit profile (SACP), which we assess at 'bbb-', and on our view of a "very high" likelihood that the government would provide timely and sufficient extraordinary support to the company in the event of financial distress. As a result, under our government-related entity (GRE) criteria, our ratings on Ecopetrol are one notch above its SACP.

- Ecopetrol's "very important" role in Colombia, given its position as the largest company in the country, its significant presence in the country's oil and gas sector, and its role as the main supplier of oil-derived products in the domestic market; and
- Its "very strong" link with the government, based on its controlling ownership and strategic oversight despite the company's clear corporate governance and independent management team.

Our view of Ecopetrol's "satisfactory" business risk profile reflects the company's leading position in Colombia's oil and gas industry, low production costs, a large reserve base, and strong reserve replacement ratio. The company's production continued to improve during the third quarter of 2014, reaching 755,000 barrels per day due to better operating conditions.

We have revised our financial risk profile assessment on Ecopetrol to "significant" from "intermediate" based on a decline in the company's EBITDA, cash flow, and credit metrics as a result of lower oil prices. Ecopetrol's debt to EBITDA will significantly increase, to about 3.3x during 2015 and 3.0x in 2016 from 1.0x as of Sept. 30, 2014. However, we estimate that as oil prices start to recover in the medium term, this metric will improve to the 2.5x-3.0x range. Our financial risk assessment also reflects Ecopetrol's aggressive capital expenditures (capex) and dividend distributions in the next few years.

Our "satisfactory" business risk profile and "significant" financial risk profile result in a split 'bbb-/bb+' anchor score. We have selected the 'bbb-' anchor based on the company's leading position in Colombia's oil and gas sector, low production costs, strong reserve replacement, and mix of reserves.

Our base-case scenario incorporates the following assumptions during the next two years:

- Approximately 760,000 barrels equivalent per day (mboed) in 2015 and about 800,000 mboed by 2016 as a result of the reversion of Rubiales field;
- A Brent price deck of $55 per barrel for 2015 and $65 per barrel for 2016, in line with our Jan. 9, 2015, price assumption;
- Annual investments of about $7 billion in 2015 and $7.7 billion in 2016; and
- Dividends payout ratio of about 70%.

These assumptions result in the following credit measures:

- Debt to EBITDA at 3.3x in 2015, and 3.0x in 2016;
- EBITDA margins, of 30%-35%, due to lower oil prices;
- Funds from operations (FFO) to debt of about 20% in 2015 and 22% in 2016; and
- Negative discretionary cash flow to debt of 25%-20% in the next two years.

Liquidity

We now assess Ecopetrol's liquidity as "adequate". We now expect lower operating cash flow generation due to lower oil prices. We expect that sources of liquidity to exceed uses by more than 1.2x in the next two years.

Principal Liquidity Sources:

- Cash balances of about $2.6 billion as of Dec. 31, 2014
- FFO of about $3.7 billion in 2015
- Working capital inflow of about $700 million in 2015

Principal Liquidity Uses:

- Debt maturities of about $600 million as of Dec. 31, 2014
- Capital spending of $2 billion annually for 2015, which is higher than the company's maintenance capex
- Dividend payments of about $2.5 billion

In addition, we view Ecopetrol as having the capacity to withstand high-impact low-probability events based on its sound banking relationships and satisfactory access to capital markets. Additionally, we believe that the company will continue to issue debt in domestic and international markets to increase its liquidity.

Outlook

The stable outlook reflects our view that Ecopetrol will continue to play a very important role in the Colombian economy and maintain its very strong links with the government. Therefore, we believe that the ratings on Ecopetrol would most likely move in tandem with those on the sovereign. On a stand-alone basis, we expect the company's debt leverage will be in line with its current financial risk profile with a debt to EBITDA below 3.5x.

Downside scenario

A downgrade is unlikely at this point, based on our assessment of the "very high" likelihood that the government would provide timely and sufficient extraordinary support to the company, if necessary. Moreover, the company's SACP would have to fall below 'bb' to result in a downgrade, which will occur if the company's debt leverage increases above 5x, leading to a "highly leveraged" financial risk profile.

Upside scenario

Any upgrade would depend on a sovereign upgrade, despite any improvement in the company's SACP because the sovereign foreign currency rating would continue to limit the one on Ecopetrol.

Ratings Score Snapshot

Corporate Credit Rating: BBB/Stable/--

Business risk: Satisfactory

- Country risk: Moderately High
- Industry risk: Intermediate Risk
- Competitive position: Satisfactory

Financial risk: Significant

- Cash flow/Leverage: Significant

Anchor: bbb-

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (No impact)
- Financial policy: Neutral (no impact)
- Management and governance: Strong (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: bbb-
Sovereign rating: foreign currency: BBB/Stable/A-2; local currency: BBB+/Stable/A-2
Likelihood of government support: Very high, (+1 notches from SACP)

Related Criteria And Research

Related Criteria

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Key Credit Factors: For The Oil And Gas Exploration And Production Industry, Dec. 12, 2013
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios and Adjustments, Nov. 19, 2013
- Rating Government-Related Entities: Methodology and Assumptions, Dec. 9, 2010

Related Research

- Standard & Poor's Revises Its Crude Oil And Natural Gas Price Assumptions, Jan. 9, 2015

Ratings List

Ratings Affirmed

Ecopetrol S.A.	
Corporate Credit Rating	BBB/Stable/--
Senior Unsecured	BBB

Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.