

01 DEC 2020

Fitch Affirms Ecopetrol's Foreign and Local Currency IDRs at 'BBB-'; Outlook Negative

Fitch Ratings - Chicago - 01 Dec 2020: Fitch Ratings has affirmed Ecopetrol S.A.'s Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) at 'BBB-'. The Rating Outlook for the IDRs is Negative. Fitch has also affirmed the company's National Long- and Short-Term ratings at 'AAA(col)'/F1+(col)'. The Rating Outlook for the National Long-Term rating is Stable.

Ecopetrol's ratings reflect the close linkage with the Republic of Colombia (Foreign and Local Currency IDRs BBB-/Negative), which currently owns 88.5% of the company. Ecopetrol's ratings also reflect the company's strategic importance for the country, as well as its ability to maintain a solid financial profile despite the decrease in hydrocarbon prices. Ecopetrol's growth strategy and associated capex plan are considered adequate for the company's credit quality and cash flow generation ability. Ecopetrol is expected to maintain a financial and credit profile supportive of its standalone credit profile (SCP), which in Fitch's view is commensurate with a 'bbb' rating. The SCP assumes the company is not owned by Colombia and that it will not receive financial support from the Colombian government.

Fitch expects Ecopetrol's credit metrics to deteriorate materially in 2020 and 2021 before starting to recover to levels in line with its SCP in 2022 as economic conditions normalize. Fitch expects Ecopetrol's leverage to increase to between 2.5x and 3.0x in 2020 from approximately 1.2x as of YE 2019 as a result of depressed oil prices globally and lower liquid fuels consumption in Colombia in 2020 due to the coronavirus-related lockdown. Ecopetrol's cash on hand amounted to approximately USD2.8 billion as of Sept. 30, 2020. The company announced capex and opex reductions of USD2 billion and approximately USD500 million, respectively, as well as a modification to dividend payments in order to preserve liquidity during 2020.

Key Rating Drivers

Linkage to Sovereign: Ecopetrol's ratings reflect the strong linkage between the credit profile of the Republic of Colombia, which owns 88.5% of the company's total capital, and that of the company. The rating also reflects the very strong incentives of the Colombian government to support Ecopetrol in the event of financial distress, given the company's strategic importance to the country as it supplies virtually all liquid fuel demand in Colombia and owns 100% of the country's refining capacity. The company has at times relied on the receipt of funds from the Colombian government to offset the difference from selling fuel in the local market at lower prices versus the export market.

Strong Financial Profile: Ecopetrol's 'bbb' SCP reflects the company's strong financial profile and resilience during the 2020 oil industry and economic downturn. Fitch calculated gross leverage as

measured by total debt to EBITDA decreased to 1.2x in 2019 from approximately 3.3x at YE 2016. Fitch expects leverage will increase to between 2.5x and 3.0x in 2020 and will thereafter continue its deleveraging trend. The improving credit profile reported between 2016 and 2019 was primarily the result of the company's debt repayments and revised business plan, lowered capex and lower dividends, which help the company entered 2020 with a strong capital structure that afforded it flexibility during the crisis.

Negative to Neutral FCF Expected: Fitch expects Ecopetrol's FCF to be neutral to marginally negative going forward, subject to revisions to investment and dividends plans. Fitch base case assumption include that the company would have a Capex of approximately USD4.5 billion over the next three years and that it will pay 60% of previous year's net income in line with its 40% to 60% dividend policy. This, coupled with Fitch's price assumptions for Brent crude oil price of between USD45/bbl and USD53/bbl, would result in negative free cash flow averaging USD770 million over the next three years, which the company would need to fund with additional debt. Should Ecopetrol marginally revise its investments while still replenishing 100% of reserves and pay dividends at the lower boundary of 40% of net income, FCF could be neutral over the rating horizon.

Stable Operating Metrics: After production cuts implemented in 2020 and potential reduction in reserves resulting from lower global hydrocarbon prices, Ecopetrol's operating metrics are expected to recover going forward to levels in line with those reported in 2019. Fitch assumes total hydrocarbons production to decline by approximately 4% to 700 thousand barrels of oil equivalent per day (boe/d) in 2020 before starting to recover to historical levels over the next three years. The company's proved reserve (1P) of 1.9 billion boe gave the company a reserve life of 7.8 years as of 2019. Ecopetrol's leverage, as measured by total debt/proved reserves, improved to USD5.8/boe as of YE 2019 from USD10/boe in 2016 due to the decrease in debt. Fitch's calculated implied pretax break even crude oil price for Ecopetrol has remained relatively stable over the past three years at approximately USD38/bbl.

Derivation Summary

Ecopetrol's rating linkage to the Colombian sovereign ratings is in line with the linkage present for most national oil and gas companies (NOCs) in the region; including Petroleos Mexicanos (Pemex; BB-/Stable), Petroleo Brasileiro S.A. (Petrobras; BB-/Negative), Petroperu S.A. (BBB+/Stable) and Empresa Nacional del Petroleo (A-/Stable). In most cases in the region, NOCs are of significant strategic importance for energy supply to the countries where they operate, as is the case in Mexico, Colombia and Brazil. NOCs can also serve as a proxy for federal government funding as in Mexico, and have strong legal ties to governments through their majority ownership, strong control, and governmental budgetary approvals.

Ecopetrol's SCP is commensurate with a 'bbb' rating, which is in line with that of Petrobras at 'bbb' given Petrobras' recent significant debt reduction. Excluding IFRS16 leases, Ecopetrol's leverage as of LTM Sept. 2020 was 2.7x. Ecopetrol's credit profile is materially higher than that of Pemex 'ccc-' SCP as a result of Ecopetrol's deleveraging capital structure versus Pemex increasing leverage trajectory.

Ecopetrol will continue reporting a stable production, which Fitch expects to stabilize between 700,000boe/d and 720,000boe/d. In contrast, Pemex's crude production has been declining in recent years. These production trajectories further support the notching differential between the two companies' SCP.

Ecopetrol's credit profile and capital structure compares favorably to that of Repsol, S.A.'s current rating level (BBB/Stable), which as of YE 2019 had a total debt to EBITDA of 2.2x, net production of 709 mboe/d, 1P reserves of 2,139 mmboe and total debt to 1P of EUR5.3/boe. Repsol's refining capacity of approximately 1mmbbl/d is much larger than that of Ecopetrol's of approximately 405mmbbl/d. Ecopetrol's credit profile is weaker than that of other international peers such as Eni SpA (A-/Stable) as a result of Ecopetrol's smaller production scale, although its capital structure is relatively equally strong. Eni SpA's leverage as of YE 2019 amounted to 1.5x, yet its production was larger and more diversified at 1.87mmboe/d, larger reserves at approximately 7.3 billion boe and total debt to 1P of EUR3.6/boe. Furthermore, Eni SpA organic reserve replacement ration has hover around 100% over the past five years and its reserve life is in excess of 10 years.

Key Assumptions

Fitch's Key Assumptions Within Its Rating Case for the Issuer

- Ecopetrol remains majority owned by Colombia;
- Brent average USD41/bbl in 2020 and USD45/bbl in 2021 before trending towards USD53/bbl in the long term;
- Stable production between 700,000boe per day and 720,000boe/d;
- Aggregate capex of approximately USD4.5 billion per year for the next three years;
- Dividends of between 40% and 60% of previous year's net income.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Although not expected in the short to medium term, an upgrade of Colombia's sovereign ratings would lead to a positive rating action or stabilization of the Negative Rating Outlook for Ecopetrol.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- A downgrade of Colombia's sovereign ratings;
- A significant weakening of the company's linkage with the government, and a lower government incentive to support couple with a material deterioration of its SCP.

Best/Worst Case Rating Scenario

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

Liquidity and Debt Structure

Strong Liquidity: Ecopetrol's strong liquidity profile is supported by cash on hand, strong access to the capital markets and an adequate debt maturity profile. Ecopetrol announced that it currently has USD2.8 billion of cash and equivalents on hand compared to roughly USD1.5 million of principal maturities due in the next twelve months. The company drew down 100% or USD665 million of its committed line of credit with Scotiabank and Mizuho Bank and also raised debt in the international markets to boost liquidity during the first half of 2020.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

Public Ratings with Credit Linkage to other ratings

Ecopetrol's ratings are linked to the sovereign of Colombia.

ESG Considerations

Ecopetrol's ESG Relevance Score for Waste and Hazardous Materials Management has been revised to '3' from '4' as the company's operations are in line with the industry standards.

Ecopetrol has an ESG Relevance Score of '4' for Exposure to Social Impacts due to multiple attacks to its pipelines, which has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

Ecopetrol has ESG Relevance Score of '4' for Governance Structure, due to its nature as a majority government-owned entity and the inherent governance risk that arise with a dominant state shareholder. this has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

Fitch Ratings Analysts

Lucas Aristizabal

Senior Director

Primary Rating Analyst

+1 312 368 3260

Fitch Ratings, Inc. One North Wacker Drive Chicago, IL 60606

Jose Luis Rivas

Director

Secondary Rating Analyst

+57 1 484 6770

Jay Djemal

Senior Director

Committee Chairperson

+1 312 368 3134

Media Contacts







Elizabeth Fogerty

New York

+1 212 908 0526

elizabeth.fogerty@thefitchgroup.com

Rating Actions

ENTITY/DEBT	RATING		RECOVERY	PRIOR
Ecopetrol S.A.	LT IDR	BBB- 	Affirmed	BBB- 
	LC LT IDR	BBB- 	Affirmed	BBB- 
	Natl LT	AAA(col) 	Affirmed	AAA(col) 
	Natl ST	F1+(col)	Affirmed	F1+(col)

ENTITY/DEBT	RATING	RECOVERY	PRIOR
• senior unsecured LT	BBB-	Affirmed	BBB-
• senior unsecured Natl LT	AAA(col)	Affirmed	AAA(col)
• senior unsecured Natl ST	F1+(col)	Affirmed	F1+(col)

RATINGS KEY OUTLOOK WATCH

POSITIVE	⊕	◊
NEGATIVE	⊖	◊
EVOLVING	◊	◆
STABLE	◉	

Applicable Criteria

[Corporate Rating Criteria \(pub.01 May 2020\) \(including rating assumption sensitivity\)](#)

[Government-Related Entities Rating Criteria \(pub.30 Sep 2020\)](#)

[Metodología de Calificaciones en Escala Nacional \(pub.08 Jun 2020\)](#)

[Metodología de Calificación de Entidades Relacionadas con el Gobierno \(pub.12 Nov 2020\)](#)

[Metodología de Calificación de Finanzas Corporativas \(pub.26 Jun 2020\)](#)

[National Scale Rating Criteria \(pub.08 Jun 2020\)](#)

Applicable Models

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

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