S&P Global Ratings

RatingsDirect®

Research Update:

Ecopetrol S.A. Outlook Revised To Negative On Same Action On Colombia, 'BBB-' Ratings Affirmed

March 26, 2020

Rating Action Overview

- On March 26, 2020, we revised our foreign currency sovereign outlook on Colombia to negative from stable.
- The negative outlook on the Sovereign indicates our view of downside risks to Colombia's fiscal and external metrics over the next 18 months. The recent drop in oil prices, along with the wider negative global impact of COVID-19, has weakened Colombia's external profile through lower export earnings and a wider current account deficit, and heightened concerns about its economic growth prospects.
- As a result, S&P Global Ratings revised its global scale rating outlook on Colombian oil company Ecopetrol S.A. to negative from stable. We also affirmed our issuer credit and issue-level ratings at 'BBB-'.

PRIMARY CREDIT ANALYST

Fabiola Ortiz

Mexico City

(52) 55-5081-4449

fabiola.ortiz
@spglobal.com

SECONDARY CONTACT

Patricia R Calvo

Mexico City

(52) 55-5081-4481

patricia.calvo
@spglobal.com

Rating Action Rationale

The rating on Ecopetrol moves in tandem with that on Colombia. In our view, Ecopetrol plays a very important role in Colombia's economy, given its position as the largest company in the country. Ecopetrol has also a significant presence in Colombia's oil and gas sector, acts as the main supplier of oil-derived products in the domestic market, and has a very strong link with the government, which has the controlling ownership (88.49% of the voting capital stock) and strategic oversight despite the company's independent management. Therefore, if we were to downgrade Colombia, we will take the same rating action on Ecopetrol.

The dramatic drop in oil prices will weaken the company's financial metrics in 2020, but will improve in 2021. The significant decline in our oil price assumptions reflects the failure of the OPEC and its allies to agree on further production cuts in response to the expected sharp reduction in global demand due to the spread of the coronavirus. In particular, we now expect crude oil prices to be substantially lower on average in 2020, resulting in a Brent oil price at $30 per barrel. Therefore, we expect Ecopetrol's near-term financial metrics to erode, but recover along with our price assumptions in 2021. Specifically, we expect the company's debt to EBITDAX above 2.5x, while its funds from operations (FFO) to debt below 25% in 2020, materially improving in 2021 given that oil price will likely rise by up $20/bbl, and lifting higher in 2022. The company also announced that it will implement as a first stage of cost reductions of up to $550 million and lower its capital spending by $1.2 billion including seismic, geological optimization studies, delays in some new opportunities on early stages, among other initiatives to mitigate the impact of lower oil prices. As a result, we affirmed Ecopetrol's stand-alone credit profile (SACP) at 'bbb-'.

We revised our assessment of Ecopetrol's liquidity to adequate from strong. We expect the company to generate lower cash flows in 2020 than we previously forecasted due to the impact of a collapse in oil prices. Therefore, we believe its sources of cash will exceed by more than 1.2x its uses. We're also considering that the company could further reduce its capital expenditures over the near term if low oil prices allow the company's liquidity remain adequate.

Outlook

The negative outlook on Ecopetrol reflects the negative outlook on the Republic of Colombia. We expect Ecopetrol to continue to play a very important role in the Colombian economy and to maintain 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.

Downside scenario

We would lower the ratings on Ecopetrol if we were to lower the sovereign ratings on Colombia. We could lower our SACP on the company in the next 12-18 months if its financial performance consistently weakens such that we expect debt to EBITDA rise above 2.0x. This would occur if crude oil prices remain low for a prolonged period. We could also lower our SACP if the company incurs additional debt, deviating from deleveraging, which could lead to a revision of the company's financial risk profile assessment to a weaker category.

Upside scenario

We would revise the outlook on Ecopetrol to stable if we were to take the same rating action on the sovereign rating on Colombia while the company's performance remains in line with our expectations.

Company Description

Ecopetrol is a vertically integrated oil company based in Bogota, Colombia. The company has presence in Colombia, Peru, Brazil, Mexico, and the U.S. Gulf Coast. It's involved in all stages of the hydrocarbon chain: exploration, production, refining, and marketing. The government of Colombia owns 88.49% of Ecopetrol, making it the controlling shareholder, while the remaining 11.51% is owned by institutional shareholders and retail investors.

Our Base-Case Scenario

- Exchange rate at COP3,650 per $1 for 2020 and COP3,750 per $1 for 2021. However, given that most of the company's revenues are in dollars or indexed to international references prices, we don't see a risk related to currency fluctuation.

- A decline to approximately 720,000 barrels of oil equivalent per day (boed) in 2020 and no growth in 2021, we believe that the company will have to scale back its production levels given that we consider that some wells won't be profitable under currently low oil prices.
- A sharp drop in the company's average realized sale price of $23 per barrel in 2020 from $58.6 in 2019, reflecting our new assumption on oil and gas prices, and assuming a differential price of Vasconia oil price of $7 per barrel with Brent. For 2021, we expect an increase to $43 per barrel as a result of our forecast of a $20 per barrel rise for Brent oil price.
- The adoption of new commercial strategies to maintain the value of the crude oil and products sold.
- A 35% drop in revenue in 2020, but recovery in 2021.
- Capex falling to about COP12 trillion in the next two years, mainly devoted for the exploration and production (E&P) segment.
- Dividend payments remain at COP3 trillion – COP6 trillion for the next two years.
- No additional debt expected.

These assumptions result in the following credit measures for the next two years:

- EBITDA margin at 40%;
- Adjusted net debt to EBITDAX of 2.6x in 2020 and recovering to 1.7x in 2021; and
- Adjusted FFO to debt of 20% in 2020 and recovering to 40% in 2021.

Liquidity

We now assess Ecopetrol's liquidity as adequate. We expect its cash sources to exceed its uses by more than 1.2x in the next 12 months and for this ratio to remain above 1.0x if EBITDA falls 30%. We also include qualitative factors in our liquidity analysis, including our view that Ecopetrol has a strong record of accessing credit facilities, access to domestic capital markets, and generally prudent risk management.

Principal Liquidity Sources:

- Cash balances of about COP7.1 trillion as of Dec. 31 2019;
- Cash FFO above COP12.3 trillion for the next 12 months; and
- Undrawn committed credit lines available for COP3.4 trillion.

Principal Liquidity Uses:

- Debt maturities of about COP2 trillion as of Dec. 31, 2019;
- Working capital outflows of COP1.7 trillion for the next 12 months;
- Adjusted capex of around COP9.3 trillion for the next 12 months; and
- Dividends of about COP7.0 trillion for the next 12 months.

Covenants

The company doesn't have any financial covenants.

Issue Ratings - Subordination Risk Analysis

Capital structure

Ecopetrol's debt currently totals COP38.2 trillion, mainly consisting of several senior unsecured bonds with an average term of 10 years. The debt at the subsidiaries' level (Bioenergy, OCENSA, ODL, Invercolsa, and Bicentenario) totals about COP3.8 trillion.

Analytical conclusions

Unsecured debt at the subsidiaries' level represents about 10% of the company's total debt, which is well below our priority debt ratio of 50%. As a result, we rate the senior unsecured notes 'BBB-', in line with the issuer credit rating.

Ratings Score Snapshot

Issuer Credit Rating

Global scale: BBB-/Negative--/--

Business risk: Satisfactory

- Country risk: Moderately high
- Industry risk: Intermediate
- Competitive position: Satisfactory

Financial risk: Intermediate

- Cash flow/Leverage: Intermediate

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: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: bbb-

Likelihood of government support: Very high

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Colombia Outlook Revised To Negative On Increased Risks To External Liquidity, Debt, And Growth; Ratings Affirmed, March 26, 2020

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Ecopetrol S.A.		
Issuer Credit Rating	BBB-/Negative/--	BBB-/Stable/--
Ratings Affirmed		
Ecopetrol S.A.		
Senior Unsecured	BBB-	

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.