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Rating Action: Moody's assigns Baa2 rating to Ecopetrol notes issue

Global Credit Research - 10 Sep 2013

New York, September 10, 2013 -- Moody's Investors Service assigned a foreign currency rating of Baa2 to up to $2.5 billion of proposed notes issued by Ecopetrol S.A. (Ecopetrol), the state oil company of Colombia. The newly issued securities are senior unsecured and pari passu with Ecopetrol's other senior foreign currency debt, which is also rated Baa2. The rating outlook is stable.

RATINGS RATIONALE

"Ecopetrol is undertaking a large notes issue to support higher capital spending under its ambitious Mega Plan," said Tom Coleman, Senior Vice President. "We view the Baa2 rating as solidly positioned and the debt increase as supportable based on the company's production growth profile and moderate financial leverage."

Ecopetrol's Baa2 global local currency issuer rating (GLCR) and senior unsecured foreign currency long-term debt rating reflects its status as Colombia's leading oil and gas producer, accounting for about two-thirds of the country's production, with a growing production, reserves and crude oil export profile. The rating derives one notch of uplift under joint-default analysis, based on a high level of government support and moderate default correlation. A baseline credit assessment (BCA) of baa3 underlies the company's Baa2 GLCR.

Proceeds from the note offering will be used for general corporate purposes, including funding of capital spending under the Mega plan. Ecopetrol is increasing upstream and infrastructure investment, which is leading to increased hydrocarbon production, primarily in heavy oil. Ecopetrol's production increased 4% year over year in the first half of 2013 to 785,000 BOE/day. Downstream capital projects include substantial expansion of refining capacity to process crude and meet rising domestic demand, as well as pipelines, storage and other transportation assets to relieve bottlenecks and deliver growing oil and gas production to market.

Ecopetrol's stable outlook incorporates rising financial leverage over the next two to three years as spending is expected to exceed internal cash flow. It also factors in the staging and execution risks of its growth strategy, higher operating and production costs, and some delays in development and production targets due to permitting and other issues. In addition, the company pays a high statutory dividend, which will compete with funds needed for reinvestment. However, growing production and strong oil-based cash margins are expected to support internal cash flow, and we do not expect higher financial leverage to affect its rating. The company could also access the equity markets in the future to help moderate rising leverage.

Despite higher spending and expected debt increases, Ecopetrol could be upgraded in the medium-term as it continues to grow production and execute on the Mega plan while maintaining moderate financial leverage. Its BCA and debt ratings could be downgraded if leverage increases materially or if production growth significantly lags expectations. The ratings could also be downgraded if we viewed the government likelihood of support for Ecopetrol to be weaker.

The principal methodology used in this rating was the Global Integrated Oil & Gas Industry Methodology published in November 2009. Other methodologies used include the Government-Related Issuers methodology published in July 2010. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

Ecopetrol S.A. is headquartered in Bogota, Colombia.

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Thomas S Coleman
Senior Vice President
Corporate Finance Group
Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
U.S.A.
JOURNALISTS: 212-553-0376
SUBSCRIBERS: 212-553-1653

Steven Wood
MD - Corporate Finance
Corporate Finance Group
JOURNALISTS: 212-553-0376
SUBSCRIBERS: 212-553-1653

Releasing Office:
Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
U.S.A.
JOURNALISTS: 212-553-0376
SUBSCRIBERS: 212-553-1653

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