

03 Dec 2019 | Affirmation

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

Fitch Ratings-Chicago-03 December 2019:

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 of 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.

Ecopetrol S.A.; Long Term Issuer Default Rating; Affirmed; BBB; RO:Neg
 ; Local Currency Long Term Issuer Default Rating; Affirmed; BBB; RO:Neg
 ; National Long Term Rating; Affirmed; AAA(col); RO:Sta
 ; National Short Term Rating; Affirmed; F1+(col)
 ----senior unsecured; Long Term Rating; Affirmed; BBB
 ----senior unsecured; National Long Term Rating; Affirmed; AAA(col)
 ----senior unsecured; National Short Term Rating; Affirmed; F1+(col)

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 the Colombian government has 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. From time to time, the company relies 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 as it continued to improve its credit metrics in 2019. Fitch calculated gross leverage, measured by total debt to EBITDA, decreased to 1.2x as of the LTM ended Sept. 30, 2019 from approximately 3.3x at YE 2016. The improving credit profile is primarily the result of the company's debt repayments and revised business plan, which lowered capex. The company's declared dividends also decreased to a fraction of historical levels as a result of the decrease in hydrocarbon prices. Fitch expects the company to now stabilize its capital structure at current levels and for potential dividends or capex increases to not affect Ecopetrol's leverage.

Neutral FCF Expected: Fitch expects Ecopetrol's FCF to be neutral to marginally negative in the foreseeable future as a result of the company's dividend policy and projected capex. Ecopetrol recently announced an increase in annual capex to between USD4.5 billion and USD5.5 billion and dividends of 60% of net income for 2020. During the LTM ended Sept. 30, 2019, Ecopetrol's capex amounted to approximately USD3.3 billion, down from an annual average of approximately USD6.9 billion during 2013 to 2015; the company also declared lower dividends of approximately USD3.2 billion during the same period, down from an annual average of approximately USD4.2 billion during 2013 to 2015. During the LTM ended Sept. 30, 2019, Ecopetrol reported EBITDA of approximately USD9.4 billion, up from USD7.9 billion in 2017. Total debt as of September 2019 was approximately USD11.7 billion.

Manageable Capex Plan: Ecopetrol plans to fund its approximately USD12 billion-USD15 billion capex program for 2019-2021 using internal cash flow generation. The company marginally improved its reserve life during 2018 as a result of a 129% reserve replacement ratio to 7.2 years from a low of approximately 6.8 years as of 2016. The company requires continuing focusing its investment plan on building up its reserve base, which is in line with the company's capex program. Fitch expects Ecopetrol's reserves and reserve life to continue improving as a result of ongoing E&P capex as well as the recent joint venture (JV) with Occidental Petroleum Corp. (BBB+/Stable) in the U.S. unconventional and its recent 30% stake acquisition in Gato Mato, Brazil.

Stable Operating Metrics: Ecopetrol's operating metrics should remain relatively stable and in line with the assigned rating. The company's proved reserve (1P) of 1.7 billion boe gives the company a reserve life of 7.2 years as of 2018. The company reported reserve additions of 307 million boe, of which 47 million boe were due to price revision and the balance was due to improvements, extension and discoveries. Ecopetrol's leverage, as measured by total debt/proved reserves,

improved to USD6.8 per boe as of June 2019 from USD10 per boe in 2016 as a result of the decrease in debt. Fitch's calculated implied pre-tax 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 Pemex (IDR BB+/Negative), Petrobras (IDR BB-/Stable), PetroPeru (IDR BBB+) and Enap (IDR 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 at times governmental budgetary approvals.

Ecopetrol's SCP is commensurate with a 'bbb' rating, which is two notches higher than that of Petrobras at 'bb+' given Petrobras' higher leverage level. Ecopetrol's gross leverage as of September 2019 was 1.2x, compared to Petrobras' gross leverage was 3.2x as of the same period.

Ecopetrol's credit profile is nine notches higher than that of Pemex 'ccc' SCP as a result of Ecopetrol's deleveraging capital structure versus Pemex increasing leverage trajectory. Furthermore, Ecopetrol has and is expected to continue reporting a stable production, which Fitch expects to stabilize between 725,000 boe/d and 750,000 boe/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' SA credit profiles.

Ecopetrol's credit profile and capital structure compares favorably to that of Repsol's current rating level (BBB/Positive), which as of YE 2018 had a total debt to EBITDA of 2.1x, net production of 715 mboe/d, 1P reserves of 2,340 mboe and total debt to 1P of EUR5.3/boe. Ecopetrol's leverage as of the September 2019 was 1.2x. Its net production amounted to 720 mboe/d and 1P reserves were 1,727 mboe. Repsol's refining capacity of approximately 1 mmbbl/d is much larger than that of Ecopetrol's of approximately 405 mm bbl/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 2018 amounted to 1.6x, yet its production was larger and more diversified at 1.85 mboe/d, larger reserves at approximately 7.1 bn boe and total debt to 1P of EUR3.9/boe. Furthermore, Eni SpA organic reserve replacement ration has met or exceeded 100% over the past five years and its reserve life is in excess of 10 years.

Key Assumptions

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

- Ecopetrol remains majority owned by the Republic of Colombia;
- Brent and WTI oil prices trend towards USD57.5/bbl and USD55/bbl, respectively, in the long term;
- Stable production, trending towards 750,000 boe per day by 2021;
- Aggregate capex of approximately USD5 billion per year going forward;
- Dividends of 60% of previous year's net income.

RATING SENSITIVITIES

Developments That May, Individually or Collectively, Lead to Positive Rating Action

- An upgrade of Colombia's sovereign ratings.

Developments That May, Individually or Collectively, Lead to Negative Rating Action

- 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 deterioration of its standalone credit profile.

Liquidity and Debt Structure

Strong Liquidity: Ecopetrol's strong liquidity profile is supported by cash on hand, positive cash flow generation, strong access to the capital markets and an adequate debt maturity profile. As of Sept. 30, 2019, Ecopetrol reported USD3.3 billion of cash and equivalents on hand compared to roughly USD1.3 billion of short-term debt and USD11.7 billion of total debt. The company also has a signed committed line of credit for USD665 million with Scotiabank and Mizuho Bank.

The company does not face significant financing needs over the foreseeable future as its capex plan and dividend policy is expected to result in a positive cash flow.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of 3 - 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.

Ecopetrol has an ESG Relevance Score of 4 for waste & hazardous materials management due to oil spills the company has experienced in the past.

The company has a relevance score of 4 for exposure to social impacts due to multiple attacks to its pipelines.

Ecopetrol's score for Governance Structure (GGV) is 4 resulting from its nature as a majority government owned entity and the inherent governance risk that arise with a dominant state shareholder.

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Applicable Criteria

[Corporate Rating Criteria \(pub. 19 Feb 2019\)](#)

[Government-Related Entities Rating Criteria \(pub. 13 Nov 2019\)](#)

[Metodología de Calificaciones en Escala Nacional \(pub. 02 Aug 2018\)](#)

[Metodología de Calificación de Entidades Relacionadas con el Gobierno \(pub. 20 Dec 2018\)](#)

[Metodología de Calificación de Finanzas Corporativas \(pub. 16 Apr 2019\)](#)

[National Scale Ratings Criteria \(pub. 18 Jul 2018\)](#)

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