

Rating Action: Moody's upgrades Ecopetrol's BCA to ba1 and affirms Baa3 rating; stable outlook

16 Jul 2018

New York, July 16, 2018 -- Moody's Investors Service (Moody's) affirmed Ecopetrol S.A. (Ecopetrol)'s Baa3 senior unsecured ratings and upgraded the company's BCA (Baseline Credit Assessment) to ba1 from ba3 based on lower reserve replacement risk and solid credit metrics. The rating outlook remains stable.

Outlook Actions:

..Issuer: Ecopetrol S.A.

....Outlook, Maintained Stable

Affirmations:

..Issuer: Ecopetrol S.A.

.... Issuer Rating, Affirmed Baa3

....Senior Unsecured Regular Bond/Debenture, Affirmed Baa3

RATINGS RATIONALE

In 2014-16, Ecopetrol's finding and development costs were high and reserve replacement rates were low, which adversely affected returns and reserve life. However, since late 2016, higher oil prices combined with better operating and capital efficiency have helped Ecopetrol improve credit metrics and cash flow. "The rating action was based on our belief that Ecopetrol will be able to maintain current reserve life at around 7 years through a solid reserve replacement strategy and that its credit metrics will remain strong", said Nymia Almeida, a Senior Vice President in Moody's. The company plans to i) continue entering into associations with large technically capable companies, which will help it optimize enhanced recovery processes and reduce costs; ii) invest in small to mid-size onshore assets that can add reserves at competitive costs; iii) develop unconventional fields, especially in the Magdalena basin, in association with third parties; iv) grow inorganically outside Colombia, primarily in projects in the U.S., Mexico and Brazil, in joint-venture with experienced partners.

The rating action was also based on Ecopetrol's solid balance sheet and management's commitment to protect credit metrics, which supports its capital investment strategy. Management's maximum limit for debt/EBITDA is 2.5 times, but it has been below 2 times since the end of 2017. Moody's believes that this credit metric will be at 1.6 times in December 2018.

Ecopetrol's Baa3 ratings and ba1 BCA continue to reflect the company's status as Colombia's leading oil and gas producer, accounting for about two-thirds of the country's production and 100% of the supply of oil products. The ratings also take into consideration Ecopetrol's solid and relatively stable cash flows from its midstream subsidiary, Cenit S.A.S. (unrated), which includes Oleoducto Central S.A. (Baa3 stable). Furthermore, Moody's assumes high probability of support from the Government of Colombia (Baa2 negative) and a moderate default dependence between the two entities. This assessment results in one notch uplift of Ecopetrol's senior unsecured rating to Baa3 from its ba1 BCA, which reflects the company's intrinsic credit risk without support considerations.

Ecopetrol's liquidity position is good and refinancing risk is low. Cash on hand of \$4.4 billion as of March 2018 favorably compares to maturing debt in the amount of \$532 million in the remainder of 2018 and \$2 billion in 2019. In addition, operating results for the first quarter of 2018 were positive and, based on an assumption of 55 dollars per barrel of Brent, the company should not need external funding for the next 12-18 months.

The stable rating outlook is based on Moody's view that Ecopetrol will be successful in continue reducing operating costs, increasing reserve replacement rate, and at least sustaining reserve life at current levels. The

stable outlook also assumes that the company would not be materially affected by the investigations related to Reficar.

Ecopetrol's BCA could be positively affected if the company manages to demonstrate ability to grow production and replace reserves without affecting its credit metrics. Specifically, if the company's Leverage Full Cycle Ratio is above 1.5 times, which would indicate low finding and development costs, and its retained cash flow/net debt is sustained at current levels, the BCA could rise to baa3. A rating upgrade for Ecopetrol is unlikely given the negative rating outlook on the Government of Colombia. If the Government's rating were to be affirmed at Baa2 and the outlook changed to stable, then Ecopetrol could be upgraded if the company also improves its fundamental credit profile and BCA. Moody's views it as unlikely that Ecopetrol could be rated above the sovereign rating.

A ratings downgrade could occur if Ecopetrol's faces liquidity constraints, its reserve life takes a negative trend or if retained cash flow/net debt is below 20% for the foreseeable future. Furthermore, any material adverse consequence on the company's operating or financial risk profile from the Reficar investigations could prompt a rating downgrade. In addition, because Ecopetrol's ratings benefit from implicit support from the government of Colombia, a downgrade of the government's rating to Baa3 with a negative outlook or a lower rating, or a change in Moody's assumptions about government support, could lead to a negative action on Ecopetrol's ratings.

The methodologies used in these ratings were Global Integrated Oil & Gas Industry published in October 2016, and Government-Related Issuers published in June 2018. Please see the Rating Methodologies page on www.moody.com for a copy of these methodologies.

Ecopetrol, 88% owned by the government of Colombia, is the largest integrated oil and gas company in the country. Its production averaged 715 mboed for the last twelve months ended March 2018, when total assets amounted to \$42 billion.

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