

Rating Action: Moody's affirms Ecopetrol Baa3 rating, changes outlook to negative

31 Aug 2021

New York, August 31, 2021 -- Moody's Investors Service (Moody's) affirmed Ecopetrol S.A.'s (Ecopetrol) Baa3 senior unsecured ratings and its Baseline Credit Assessment (BCA) at ba1. Simultaneously, Moody's changed the rating outlook to negative from stable due to the company's higher leverage and refinancing risk, reflecting a more aggressive financial policy in a context of volatile commodities prices.

Affirmations:

..Issuer: Ecopetrol S.A.

.... Issuer Rating, Affirmed Baa3

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

Outlook Actions:

..Issuer: Ecopetrol S.A.

....Outlook, Changed to Negative from Stable

RATINGS RATIONALE

The change in Ecopetrol's Baa3 rating outlook to negative from stable was based on i. the company's decision to fund the acquisition of 51.4% of Interconexión Eléctrica S.A. E.S.P.'s (ISA, Baa2 stable) capital for about \$3.67 billion with debt only, which, on top of the \$6.1 billion in reported debt in ISA's balance sheet as of March 2021, will increase Ecopetrol's financial leverage and ii. the fact that the related bridge loan has a two-year maturity, which generates refinancing risk. Ecopetrol originally planned to fund the acquisition of ISA with sale of shares and assets, in addition to new debt.

In August 2021 Ecopetrol announced the payment for the acquisition of a controlling stake of ISA, a publicly traded power company owned by the Government of Colombia (Baa2 negative). On the positive side, ISA generates a more stable and predictable EBITDA compared to that of Ecopetrol's oil and gas business, which increases cash flow visibility. It is also positive that ISA will contribute to expand Ecopetrol's geographic and business diversification since the transmission power company operates in Colombia, Brazil, Peru, and Chile. In addition, after consolidation of ISA, Ecopetrol's rate of metric tons of carbon emission per each billion of EBITDA (MtCO₂/EBITDA) will decline to 1.37x from 1.61x because the same index for ISA's is 0.02x. However, and despite ISA's strong EBITDA margins at over 70%, its Moody's-adjusted financial leverage for the last twelve months (LTM) ended in March 2021 was at 4.9 times, well above that of Ecopetrol of 2.0 times for the LTM ended June 2021.

Robust oil and gas prices have supported Ecopetrol's cash generation so far in 2021 and Moody's believes that the company will be able to reduce and refinance debt in the next 12-18 months, based on an estimated average Brent price of \$55 dollars per barrel (dpb) in 2022. However, commodities prices volatility remains a risk for Ecopetrol, especially in the context of higher debt leverage and tighter debt amortization schedule.

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, as well as its strong management team. The ratings also take into consideration Ecopetrol's solid and relatively stable cash flows from its midstream subsidiary, Cenit SAS, which includes Oleoducto Central S.A. (Baa3 stable). Furthermore, Moody's assumes high probability of support from the Government of Colombia and a moderate default dependence between the two entities. This assessment results in a one-notch uplift of Ecopetrol's senior unsecured rating to Baa3 from its ba1 BCA (baseline credit assessment), which reflects the company's intrinsic credit risk without support considerations.

Ecopetrol's reserve replacement strategy has been well executed in recent years, with an average reserve replacement rate of 116% in 2018-20. Ecopetrol's liquidity is adequate and its refinancing risk is higher but manageable, under a scenario of average Brent prices of 65 dpb for the second half of 2021 and 55 dpb for 2022.

The negative rating outlook is based on Moody's view that Ecopetrol's debt leverage and refinancing risk may remain elevated in the next 12 months for a Baa3 rating category.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

An upgrade of Ecopetrol's ba1 BCA or Baa3 rating is unlikely in the next 12 to 18 months given the negative rating outlook. However, if the company demonstrates the ability to reduce debt while growing production and keeping proved reserve life stable, its rating outlook could be stabilized. Specifically, its rating outlook could be stabilized if the company's Leverage Full Cycle Ratio remains at 1.5 times, which would indicate stable finding and development costs, and its retained cash flow/net debt were to remain at over 30% on a sustained basis. However, for the company's BCA and rating to rise, retained cash flow/net debt would have to be at over 40% and the Government of Colombia's rating would have to be sustained at Baa2 because in Moody's views it is unlikely that Ecopetrol would be rated above the sovereign rating.

A ratings downgrade could occur if Ecopetrol faces liquidity constraints, if its reserve life declines significantly on a sustained basis, or if retained cash flow/net debt declines to around 20%. In addition, because Ecopetrol's ratings benefit from implicit support from the Government of Colombia, a negative action on the government's 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 Integrated Oil and Gas Methodology published in September 2019 and available at https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC_1172345, and Government-Related Issuers Methodology published in February 2020 and available at https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC_1186207. Alternatively, please see the Rating Methodologies page on www.moody.com for a copy of these methodologies.

Ecopetrol, 88.5% owned by the government of Colombia, is the largest integrated oil and gas company in the country. The company has three business segments, namely exploration and production, refining activities and transportation and logistics. Its gross production averaged close to 640 mboed in 2020, and total assets amounted to \$40 billion at June 30, 2021.

ISA, headquartered in Medellin, Colombia, is an operating holding company with businesses in the electricity transmission, toll roads, telecommunications, and systems management sectors. The company holds direct and indirect ownership stakes in a portfolio of subsidiaries located in Colombia, Brazil, Peru, and Chile.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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Nymia C. Almeida
Senior Vice President
Corporate Finance Group
Moody's de Mexico S.A. de C.V
Ave. Paseo de las Palmas
No. 405 - 502
Col. Lomas de Chapultepec
Mexico, DF 11000
Mexico
JOURNALISTS: 1 888 779 5833
Client Service: 1 212 553 1653

Marcos Schmidt
Associate Managing Director
Corporate Finance Group
JOURNALISTS: 0 800 891 2518
Client Service: 1 212 553 1653

Releasing Office:
Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
U.S.A.
JOURNALISTS: 1 212 553 0376
Client Service: 1 212 553 1653

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