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Research Update:

**Ecopetrol S.A. 'BBB' Ratings Affirmed;
Outlook Remains Negative;
Stand-Alone Credit Profile Raised To
'bb+' From 'bb'**

Primary Credit Analyst:

Marcela Duenas, Mexico City (52) 55-5081-4437; marcela.duenas@spglobal.com

Secondary Contact:

Fabiola Ortiz, Mexico City (52) 55-5081-4449; fabiola.ortiz@spglobal.com

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Overview

- We have recently seen better-than-expected credit measures at Ecopetrol S.A. and believe they will continue to improve modestly over the next year, reflecting higher oil prices and the company's efforts to reduce operating costs and become more efficient.
- As a result we are raising our stand-alone credit profile (SACP) on the Colombia-based oil and gas company to 'bb+' from 'bb'.
- We are also affirming our 'BBB' long-term corporate credit rating on Ecopetrol and our 'BBB' rating on the company's senior unsecured debt.
- The negative outlook reflects our negative outlook on the Republic of Colombia (foreign currency BBB/Negative/A-2; local currency BBB+/Negative/A-2). We expect Ecopetrol to continue to play a very important role in the Colombian economy and to maintain its very strong links with the government. Therefore, we believe that the ratings on Ecopetrol will most likely move in tandem with those on the sovereign.

Rating Action

On June 27, 2017, S&P Global Ratings affirmed its 'BBB' long-term corporate credit rating on Ecopetrol S.A. The outlook remains negative. At the same time, we affirmed our 'BBB' rating on its senior unsecured debt and raised our SACP on Ecopetrol to 'bb+' from 'bb'.

Rationale

Our rating affirmation reflects our assessment of a very high likelihood that the Colombian government will provide timely and sufficient extraordinary support if Ecopetrol is under financial distress. We see Ecopetrol playing a very important role in Colombia, given its position as the largest company in the country. The company has 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 controlling ownership and strategic oversight despite the company's independent management.

The SACP upgrade reflects that despite lower average production in 2016 of 718,000 barrels oil equivalent per day (boed), resulting from lower capital

spending and the natural decline of the fields, Ecopetrol reported better than expected key credit metrics, particularly debt to EBITDA of less than 3x and positive discretionary cash flow.

In the face of lower oil prices, Ecopetrol cut costs across all of its business segments, concentrating on a strategy of profitable barrels. It also focused on achieving structural efficiencies, such as reducing the dilution costs of heavy crude, and implementing more efficient procurement and services strategies. As a result, the company achieved higher-than-expected savings. EBITDA rose and Ecopetrol posted an adjusted EBITDA margin of around 39% in 2016. We believe that despite slightly lower production, these ratios will improve modestly in 2017, driven by recovering oil prices, a lower spread between Ecopetrol's crude basket prices and the Brent, and continued operating efficiencies. We therefore expect to see debt to EBITDA of 2.4x, funds from operations (FFO) to debt of 22%, and discounted cash flow (DCF) to debt of about 8%-10%.

We expect slightly lower production for 2017 compared to 2016, reflecting the temporary closure of the Caño-Limon-Coveñas oil pipeline, the natural decline of the oil and gas fields, and lower natural gas sales. For the following years we anticipate a slight recovery in production, driven by higher capital spending (capex) dedicated to production (75% of total capex) and the company's projects to increase the recovery factor of existing mature fields. We are still concerned, however about the company's declining reserves and its challenge maintaining its pace of production.

We also expect that the company will continue to dedicate capex for its national and international exploratory strategy. It could also potentially use some of its cash to pursue inorganic growth.

Our base-case scenario assumes the following:

Production levels will be approximately 715,000 boed in 2017 and 733,000 boed in 2018;

An average realized sale price of \$41 per barrel of oil equivalent (boe) in 2017 and 2018, which ultimately depends on our price assumption for Brent crude oil of \$50 per barrel for the following two years (minus \$9 per barrel given the current spread with Ecopetrol's crude basket);

The company will continue to execute efficiencies and cost savings according to its transformation plan, resulting in an adjusted EBITDA margin of about 40% in the next 2 years;

Annual capex of about \$3 billion in the next two years, with 90% used for exploration and production, as the company has already finished its midstream and downstream projects;

The resumption of dividend payments in line with its new dividend policy of a 40% payout ratio;

Proceeds of \$74 million in 2017 from the sale of some minor fields and the remaining part of Empresa de Energía de Bogotá (EEB). We don't expect any major divestments because Ecopetrol has no immediate cash needs; and

The ability, in our view, to generate cash for debt repayment and to begin amortizing debt as it comes due.

These assumptions result in the following credit measures:

Adjusted net debt to EBITDAX (EBITDA plus exploration expenses) of about 2.4x in 2017 and 2.2x in 2018;

Adjusted FFO to debt of 22%-24% for the next two years; and
DCF of 8%-10% for the next two years.

Liquidity

We assess Ecopetrol's liquidity as strong, supported by a lower cost structure and moderating oil prices. Our assessment reflects our expectations that the company's sources of liquidity will exceed its uses by more than 1.5x in 2017 and remain above 1x over the subsequent 12 months. Ecopetrol's liquidity is supported by our view that the company has the capacity to withstand high-impact low-probability events based on its sound banking relationships and satisfactory access to capital markets. We also believe that the company will have committed credit lines to strengthen its liquidity.

Principal Liquidity Sources:

- Cash balances of about \$2.8 billion as of March 31, 2017;
- Cash FFO above \$5 billion for the next 12 months; and
- Asset sales of about \$74 million from EBB and some minor fields for the next 12 months.

Principal Liquidity uses:

- Debt maturities of about \$1.4 billion as of March 31, 2017.
- Working capital outflows of \$234 million for the next 12 months
- CAPEX of around \$3 billion for the next 12 months.
- Dividends of about \$440 million for the next 12 months.

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 if the company generates lower-than-expected EBITDA because of a decline in oil prices, a continued decline in production and reserves, or if Ecopetrol incurs additional debt that pushes debt to EBITDAX above 3x and DCF below 5%.

Upside scenario

We would revise the outlook on Ecopetrol back to stable if we were to take the same rating action on the sovereign rating on Colombia and the company's performance remains in line with our expectations. We could raise the company's SACP if debt to EBITDAX was below 2x and DCF was at or above 10%.

Ratings Score Snapshot

Corporate Credit Rating

Global Scale: BBB/Negative/--

Business risk: Satisfactory

Country risk: Moderately High

Industry risk: Intermediate

Competitive position: Satisfactory

Financial risk: Significant

Cash flow/Leverage: Significant

Anchor: bb+

Modifiers

Diversification/Portfolio effect: Neutral (no impact)

Capital structure: Neutral (no impact)

Liquidity: Strong (no impact)

Financial policy: Neutral (no impact)

Management and governance: Satisfactory (no impact)

Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: bb+

Likelihood of government support: Very high

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- 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
- Criteria - Corporates - Industrials: Key Credit Factors For The Oil And Gas Exploration And Production Industry, Dec. 12, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013

- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, 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
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Ratings List

Ratings Affirmed

Ecopetrol S.A.

Corporate Credit Rating BBB/Negative/--

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.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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