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Research Update:

Ecopetrol S.A. 'BBB' Ratings Affirmed, Outlook Remains Stable

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Overview

- Colombia-based national oil company Ecopetrol benefits from a "very high" likelihood of extraordinary support from the government, and we expect it to maintain cash flow leverage metrics consistent with its "intermediate" financial risk profile.
- We are affirming our 'BBB' corporate credit rating on Ecopetrol.
- The stable outlook mirrors that on the sovereign, as we expect the company to continue playing a significant role in Colombia's economy.

Rating Action

On May 8, 2014, Standard & Poor's Ratings Services affirmed its 'BBB' long-term corporate credit rating on Ecopetrol S.A. At the same time, we affirmed our 'BBB' senior unsecured rating on the company. The outlook remains stable. The rating affirmations follow our regular annual review.

Rationale

The rating on Ecopetrol is based on its stand-alone credit profile (SACP), which we assess at 'bbb-', and on our view a "very high" likelihood that the government would provide timely and sufficient extraordinary support to Ecopetrol in the event of financial distress. As a result, under our government-related entity (GRE) criteria, our ratings on Ecopetrol are one notch above of its SACP.

We base our view of the "very high" likelihood of support on:
- Ecopetrol's "very important" role in Colombia, given its position as the largest company in the country and the main supplier of oil-derived products in the local market; and
- Ecopetrol's "very strong" link with the government, based on its government ownership and our belief that it will provide Ecopetrol with sufficient and timely support in all circumstances despite the company's clear corporate governance and independent management team.

The 'bbb-' SACP is based on the company's leading position in Colombia's oil and gas industry, low production costs, large reserve base and strong reserve replacement, and proven access to capital markets. It also incorporates our expectations that the company can finance its capital expenditures by maintaining its cash flow leverage metrics in line with our assessment of its "intermediate" financial risk profile.

Ecopetrol's average production, including net interests in subsidiaries and affiliates, was 765.7 thousand barrels equivalent per day (mboed) for the first quarter of 2014, down 3.2% from the same period of 2013. This was a result of several attacks on the company's infrastructure and blockades by communities in several regions. We expect that the company will reach its estimated 1 million boed production level by 2015 as a result of its aggressive capital investments of about $7.5 billion per year for the next three years. However, we don't expect these costs to weaken the company's financial performance thanks to its manageable business plan and favorable market conditions where oil prices surpass $70 per barrel.

The company's stand-alone financial risk profile is "intermediate," reflecting a debt to EBITDAX of less than 1.0x as of March 31, 2014. It also reflects Ecopetrol's aggressive capital expenditures (capex) in the next few years, due to the company's commitment to increase production, and our expectation for dividend payments given its positive free operating cash flow generation in the following two to three years. Although we estimate that Ecopetrol will partly fund its capital investments through debt, we expect its debt to EBITDAX ratio to remain at about 1.0x during the next two to three years.

Our base-case scenario incorporates the following assumptions:

- Approximately 1 million boepd by the end of 2015.
- A Brent price deck of $100 per barrel for 2014 and $95 per barrel for the next two years, given the company's high sales to this market.
- The company will invest about $7.5 billion annually to reach its expected production level in 2015.
- Lower EBITDA margins, of 40%-45% due to higher transportation costs as a result of the change in the model of the oil pipeline companies from cost centers to benefit centers.
- Dividends distribution of about $5 billion per year during the next three years.

These assumptions result in the following credit measures:

- Debt to EBITDA at 0.7x in 2014; and
- Funds from operations (FFO) to debt of about 75%.

Liquidity

We assess Ecopetrol's liquidity as "strong" and sufficient to cover its needs for the next 12-18 months, as we believe the company's sources of liquidity will exceed its uses by 1.50x based on our Brent price deck assumptions.

Principal Liquidity Sources:

- Cash balances of about $4.6 billion as of Dec. 31, 2013;
- FFO of about $13 million in 2014; and
- Undrawn committed credit facilities of $340 million from Exim-Bank.

Principal Liquidity Uses:

- Capital spending of $7.5 billion annually for 2014 and 2015, but the company has the flexibility to scale back these investments in case of a stress scenario;
- Working capital outflow of about $800 million in 2014;
- Dividend payments of about $5 billion according to company's dividend policy of a 80% payout ratio during 2014 and 70% afterwards; and
- Debt maturities of about $700 million.

Our liquidity analysis also incorporates qualitative factors, including 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, as seen in its 2013 debt issuance of $2.5 billion. Additionally, we believe that the company will issue debt in local and international markets to increase its liquidity.

Outlook

The stable outlook reflects our view that Ecopetrol will continue to play a very important role in the Colombian economy and maintain its 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. On a stand-alone basis, we expect the company to carry out its capex plan by maintaining a total debt to EBITDAX below 1.5x, offset by negligible or negative discretionary cash flow. However, the company can reduce capex and dividends under stress conditions.

Downside scenario

A downgrade is unlikely at this point based on our assessment of the "very high" likelihood that the government would provide timely and sufficient extraordinary support to the company, if necessary. Moreover, the company's SACP would have to fall below 'bb' to result in a downgrade.

Upside scenario

Any upgrade would depend on a sovereign upgrade, despite any improvement in the company's SACP, as the final rating would remain capped by the sovereign foreign currency rating.

Ratings Score Snapshot

Corporate Credit Rating: BBB/Stable/--

Business risk: Satisfactory

- Country risk: Moderately High
- Industry risk: Intermediate Risk
- Competitive position: Satisfactory

Financial risk: Intermediate
- Cash flow/Leverage: Intermediate

Anchor: bbb-
Modifiers
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Strong (No impact)
- Financial policy: Neutral (no impact)
- Management and governance: Strong (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: bbb-
Sovereign rating: foreign currency: BBB/Stable/A-2; local currency: BBB+/Stable/A-2
Likelihood of government support: Very high, (+1 notches from SACP)

Related Criteria And Research

Related Criteria

- Methodology And Assumptions: Liquidity Descriptors for Global Corporate Issuers, Jan. 2, 2014
- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, Sept. 18, 2012
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010
- Stand-Alone Credit Profiles: One Component of a Rating, Oct. 1, 2010

Related Research

- Republic of Colombia 'BBB/A-2' Foreign Currency And 'BBB+/A-2' Local Currency Ratings Affirmed; Outlook Is Stable, April 29, 2014

Ratings List

Ratings Affirmed

Ecopetrol S.A.	
Corporate Credit Rating	BBB/Stable/--
Senior Unsecured	BBB

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 Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.