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Research Update:

Ecopetrol Credit Profile Revised To 'bb' From 'bbb-' And Outlook To Negative On New Oil Price Assumptions, Rtgs Affirmed

Primary Credit Analyst:
Marcela Duenas, Mexico City (52) 55-5081-4437; marcela.duenas@standardandpoors.com

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Overview

- On Jan. 12, 2016, we lowered our oil and natural gas price assumptions based on market oversupply.
- We're lowering Ecopetrol's stand-alone credit profile (SACP) to 'bb' from 'bbb-' to reflect the company's weaker credit metrics given the current environment in the industry.
- We're revising our outlook on the company to negative from stable to reflect our expectation that if prices remain weaker than in our base-case assumptions, its liquidity could weaken.
- We're affirming our 'BBB' corporate credit and issue-level ratings on Ecopetrol because we expect that it will maintain its very important role in Colombia's economy and very strong link with the government.

Rating Action

On Jan. 29, 2016, Standard & Poor's Ratings Services revised its outlook on Ecopetrol S.A. to negative from stable. We also affirmed our 'BBB' long-term corporate credit rating on Ecopetrol S.A. At the same time, we affirmed our 'BBB' rating on its senior unsecured debt. We also revised the company's SACP to 'bb' from 'bbb-'.

Rationale

The SACP revision reflects our expectation that Ecopetrol's credit measures will likely be weaker than we previously expected because of lower hydrocarbon price assumptions (see "S&P Lowers Its Hydrocarbon Price Deck Assumptions On Market Oversupply; Recovery Price Deck Assumptions Also Lowered," published on Jan. 12, 2016).

We believe the company will continue to operate under its austerity and cost efficiency measures due to the currently low oil prices. Some of the actions Ecopetrol has taken include reduction in capex, cost savings by renegotiating with suppliers, supply chain interventions, and staff layoffs. Additionally, Ecopetrol has shown interest in selling non-core assets as a part of a divestments plan to improve its cash flow and to focus on the upstream sector. During the third quarter of 2015, the company completed the first stage of divestment of its share interest in Empresa de Energía de Bogotá S.A.E.S.P., from which it obtained about $200 million. Ecopetrol also opened the first round in the process of selling stake in Interconexión Eléctrica S.A. to improve its operating cash flow.

We continue to assess a "very high" likelihood that the government will provide timely and sufficient extraordinary support in the case the company is under financial distress. In accordance with our criteria, we base our rating approach on our view that Ecopetrol plays a very important role in Colombia, given its position as the largest company in the country, significant presence in Colombia's oil and gas sector, role as the main supplier of oil-derived products in the domestic market, and "very strong" link with the government. The latter is based on the government's controlling ownership and strategic oversight, despite the company's independent management team.

Our view of Ecopetrol's business risk profile reflects the company's leading position in Colombia's oil and gas industry, low production costs of about $7.3 dollars per barrel, large reserve base, and strong reserve replacement ratio. As of the third quarter of 2015, the company was able to maintain its production at 761,000 barrels equivalent per day mboed despite the guerilla attacks on the Caño Limón-Coveñas pipeline, the natural decline of certain fields, and the lower prices that affected some fields with high price contract clauses. However, given the current oil price environment, we expected that the company could further reduce its capital expenditures plan, leading to a drop in the company's production of more than 7% during 2016 to 690,000 mboed. We view that a further drop in international crude oil prices could further shrink Ecopetrol's capital expenditure plan, which could continue to crimp its exploration and development activities.

Our assessment of Ecopetrol's aggressive financial risk profile incorporates the company's debt to EBITDA of 3.5x-4.0x and funds from operations (FFO) to debt of 10%-15%. After five years of positive free operating cash flow (FOCF) generation, we now estimate a shortfall as a result of the impact of lower oil prices.

Our base-case scenario assumes the following:

- Approximately 690,000 mboed in 2016 and about 630,000 mboed by 2017 as a result of lower capex;
- Average realized sale price of $30 per barrel of oil equivalent (boe) during 2016 and $35 per boe in 2017. Our average realized sale price ultimately depends on our price assumption for Brent crude oil at $40 per oil barrel (bbl) for 2016 and $45/bbl in 2017 minus applicable discounts for the company
- EBITDA of $3 billion in 2016;
- Working capital needs of about $1.8 billion during the next two years;
- Debt of $17.2 billion in 2016 and $16.4 billion in 2017;
- Annual investments of about $3.0 billion in 2016 and $2.5 billion in 2017; and
- No dividends in 2016 and 2017.
- Under these assumptions, we expect Ecopetrol to have the following financial performance:
- Reported EBITDA margins of about 25%;

- Adjusted net debt to EBITDA of about 4.2x in 2016 and 2017; and
- Adjusted FFO to debt in a range of 12%-13%.

Liquidity

We assess Ecopetrol's liquidity as adequate, which reflects our expectations that the company's sources of liquidity will exceed its uses by more than 1.2x in the next 12 months, and that net sources and uses of liquidity will remain positive even if EBITDA were to decline by 15%.

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. We expect Ecopetrol to retain its very good access to banks and debt capital markets given its relationship with the government.

Principal Liquidity Sources:

- Cash balances of about $2.997 billion as of Sept. 30 2015
- Cash FFO of about $2.949 billion for the next 12 months

Principal Liquidity Uses for the next 12 months:

- Short-term debt maturities of about $463 million
- Working capital outflows of about $1.827 billion
- Maintenance capex of $2,000 million
- Expected dividend payments of about $200 million in 2015

Outlook

The negative outlook on Ecopetrol reflects that if low prices remain below of our base-case scenario, the company's operating cash flow generation could contract, which would prompt us to revise our liquidity assessment to a weaker category. Additionally, if Ecopetrol's oil production will be significantly lower than we expect as a result of lower investment during 2016, a downgrade is possible.

Downside scenario

A negative rating action could follow if Ecopetrol generates lower-than-expected cash flow, which could result in a revision of our liquidity assessment to less than adequate or increase the company's debt leverage to above 5x, leading to a revision of the company's financial risk profile to highly leveraged. Liquidity could weaken if the Brent oil price remains below $30/bbl in 2016, while its recovery in 2017 is slower than expected. A negative action on the sovereign's local currency rating would also lead to a downgrade of Ecopetrol.

Upside scenario

An outlook revision to stable is likely if Ecopetrol's performance is in line with our expectations and it maintains an adequate liquidity position. A positive rating action on the sovereign local currency rating up to 'A' would also lead to an upgrade of the company.

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: Aggressive
- Cash flow/Leverage: Aggressive

Anchor: bb

Modifiers
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (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 And Research

Related Criteria

- Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Key Credit Factors: For The Oil And Gas Exploration And Production Industry, Dec. 12, 2013
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios and Adjustments, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Ecopetrol S.A.		

Corporate Credit Rating	BBB/Negative/--	BBB/Stable/--
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 Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.