

Energy (Oil & Gas)
Colombia
Credit Analysis

Ecopetrol S.A.

Ratings

Security Class	Current Rating
Foreign Currency IDR	BB+
Local Currency IDR	BBB-

IDR – Issuer default rating.

Outlook

Stable

Financial Data

Ecopetrol S.A. (USD Mil.)	6/30/08	12/31/07
Total Assets	28,932	23,841
Total Equity	14,773	13,285
Net income	4,541	2,496
EBITDA	7,788	4,980
EBTIDA Margin (%)	52	46

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Rating Rationale

- Ecopetrol S.A.'s (Ecopetrol) ratings are linked with the credit profile of the Republic of Colombia (local and foreign currency ratings of 'BBB-' and 'BB+', respectively), which owns 89% of the company's total capital. The company is also linked closely with the Colombian government through its exposure to changes in regulation and its receipt of subsidies from the central government.
- On a standalone basis, Ecopetrol maintains a strong financial profile. Its reserves are sizable and stable, and its production levels have been increasing. These factors, plus its dominant domestic market share, allow the company to generate consistently strong cash flows from operations and meet its obligations in a timely manner. Like other companies in this sector, Ecopetrol is vulnerable to fluctuations in international commodity prices and tightening environmental regulations requiring material investment in downstream operations.
- Due to changes made by the government in 2003, Ecopetrol has had to compete for new exploratory rights. This has resulted in high exploration and production (E&P) expenses due to a competitive bidding process and high capital expenditures that are required to increase and maintain reserves. This has resulted in Ecopetrol establishing a very aggressive capital expenditure and investment program of approximately USD60 billion for the next seven years.
- The company plans to finance this capital expenditure program using internal cash flow generation, on- and off-balance-sheet debt issuances as well as a possible secondary equity offering, which could increase the company's total floating capital to 20%, as the government's stake cannot be diluted to less than 80%. This capital expenditure program is aggressive and requires significant internal cash flow generation to be financed.

Key Rating Drivers

- Credit profile of the Republic of Colombia.
- Ecopetrol's strong financial profile.
- Fluctuations in international oil prices.

Liquidity and Debt Structure

Ecopetrol's liquidity position is currently very strong, as the company has no financial debt and an estimated USD1.7 billion of cash on hand as of June 30, 2008. Going forward, liquidity is expected to remain strong for the company, although tighter than current levels, as its capital expenditures ramp up and debt increases.

Recent Events

A decline in commodity prices holds the potential to pressure levy changes for the oil and gas industry in Colombia, as a significant percentage of government revenue proceeds comes from this industry. During 2007, total transfers from Ecopetrol to the Central Government (including royalties collected by Ecopetrol from other oil and gas companies) amounted to approximately 19% of total government income. This is

estimated to be much higher for 2008 as international oil prices reached record highs during this year. The risk of increased taxes for the industry is mitigated by the weakening of the Colombian peso against the dollar and by the fact that liquid fuels in Colombia are subsidized. Therefore, a decline in international oil prices might have a neutral effect on central government, as the country is in the process of eliminating subsidies. The lower transfer from Ecopetrol will be offset with lower subsidies by the central government, as liquid fuel prices for end users will most likely remain unchanged.

During 2007, the Colombian central government began reimbursing Ecopetrol for fuel subsidies on a monthly basis. For the year ended December 31, 2007, Ecopetrol received a total of approximately USD857 million in subsidies, or the equivalent to approximately 8% of total revenue. The Colombian government has stated its intention to progressively dismount subsidies within the next few years. The government plans to utilize the current decline of international oil prices to reduce subsidies. This subsidy dismounting initiative will make gasoline very expensive in Colombia, as the local/municipal fuel sales tax would likely remain. While the average price of regular grade gasoline in the U.S. has declined to approximately USD2.50 per gallon in recent months, in Colombia consumers are still paying approximately USD3.30 per gallon.

In April 2007, Ecopetrol transferred the Cartagena refinery's assets to Glencore International AG (Glencore) in exchange for 49.0% interest in Refinería de Cartagena S.A., a newly formed company that will expand the refinery. As a result of the spinoff, delivery of crude oil to the Cartagena refinery is now accounted for as sales on Ecopetrol's income statement.

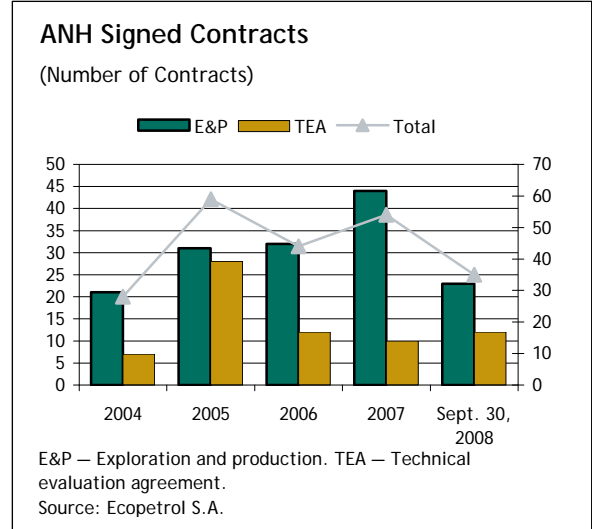
The company recently listed its stock in the New York Stock Exchange as American Depositary Receipts. This is positive for the company, as it opens up access to the international capital market and therefore a higher liquidity for the company shares.

Company Profile

Ecopetrol is a vertically integrated oil and gas company that operates primarily in Colombia. The company is 89.9% owned by the Colombian government, and the balance was placed in the Colombian stock exchange and was recently registered in the New York Stock Exchange. As of June 2008, Ecopetrol's crude oil production was approximately 438,000 barrels of oil equivalent per day (boe/d). As of year-end 2007, the company reported total proved developed and undeveloped reserves of approximately 1.2 billion barrels. The company's strategy incorporates increasing its total reserves to approximately 2.1 billion barrels, increasing production to one million boe/d by 2015 and gas sales to 1.1 billion British thermal units (Btu) per day. The company also plans to increase its refining capacity to 650,000 barrels per day (bpd).

Ecopetrol's strategy has been affected by a decree introduced in 2003 and implemented in 2004, which separated the administration of Colombian hydrocarbon resources from the company. The decree marks a relevant change in Ecopetrol's profile in terms of operations and strategy. In the past, the company was afforded low-risk access to oil reserves through its exclusive option to participate, post exploration, in any commercial discoveries made by the private sector. Going forward, while existing association agreements remain in place, future agreements depend on Ecopetrol's own strategy and performance. The company must compete for exploration blocks, or it may enter into joint ventures with other energy partners. Production from existing agreements is significant, with association-related production accounting for more than 50% of the company's average crude oil output during 2007.

Ecopetrol's current strategic plan for 2008–2015 encompasses its growth and operational consolidation goals. The company's growth goals are to be vertically integrated, producing 1 million boe/d by 2015; to have some of the top refineries and transportation systems in Latin America; and to be the best hydrocarbon supply option for Colombia. The 1 million boe/day goal seems very aggressive, as the company would have to more than double its current production level. Although Ecopetrol's production has presented an upward trend in recent years, doubling production in seven years will be costly and challenging. In line with its goals, the company has increased its exploration efforts in order to be more competitive going forward.

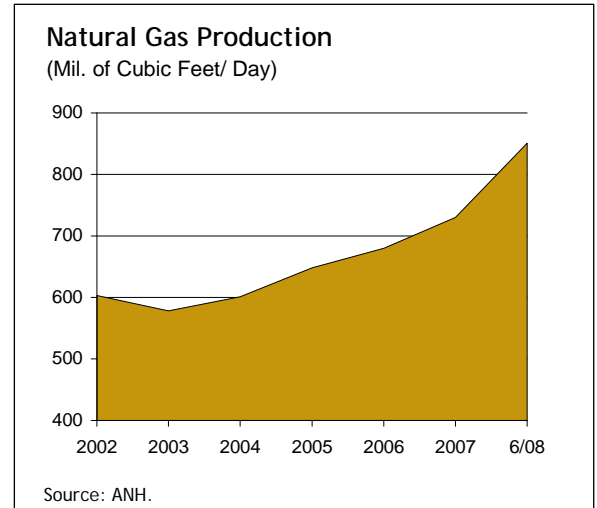
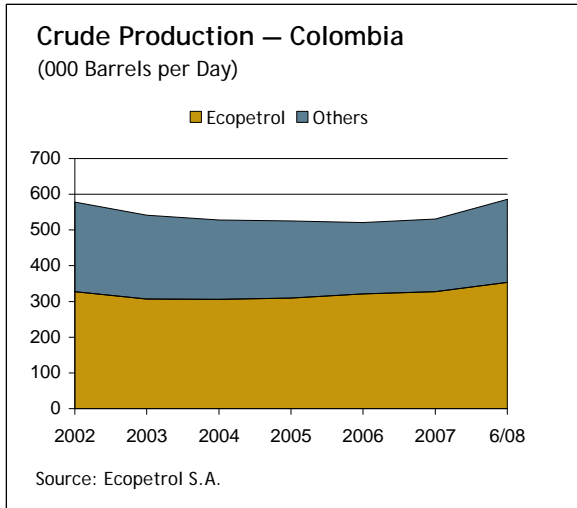


Understanding the limitations that stem from being a public sector company, Ecopetrol and the Colombian government began a capitalization process for the company. During the first phase of this process, the company placed 10.1% of its total equity in the market, diluting the government participation to 89.9%. This allowed the company to become a mixed-capital company with more independence from the central government. The main benefit from the capitalization process is that Ecopetrol now has budgetary impendency, which allows it to raise debt to finance its capital expenditure needs. In addition, the company would be able to retain human capital by offering more competitive remuneration, and it would have more operational flexibility, as its contracting process would become easier. In the past, the bureaucracy imbedded in the company's contracting process somewhat hindered Ecopetrol's flexibility to operate.

National Hydrocarbons Agency (ANH)

The Colombian government's strategy of promoting additional private-sector investment in the petroleum business is evidenced by the increased number of contracts granted. From 2005 to September 2008, the ANH had signed 151 E&P contracts and 69 technical evaluation agreements (TEA). During 2007, the ANH opened 3.3 million hectares for E&P contracts. Ecopetrol was able to obtain 10 E&P contracts during 2007.

The Colombian government aims to improve the oil sector's recovery with more attractive investment conditions. The new contract model has reduced royalty payments from a flat 20% to a sliding scale of between 8% and 25%, depending on production levels. Additionally, Ecopetrol's right to come in post exploration was eliminated. In contrast to the past, Ecopetrol would also have a measure of control and participation in the operation of projects, with a sharing of production and investment through association agreements.



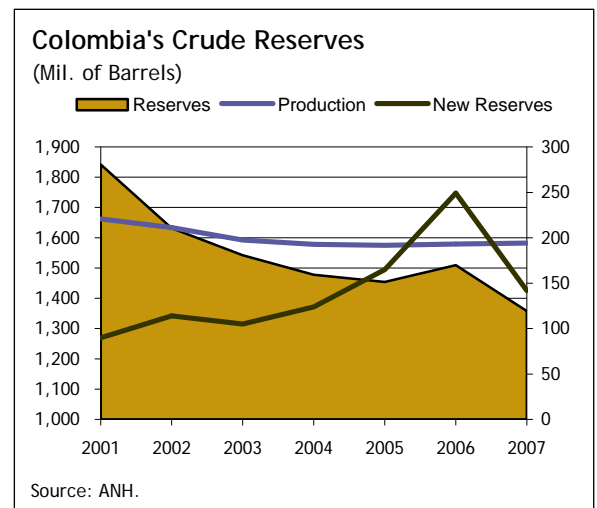
Reserves and Production

Ecopetrol uses its crude oil production for the country's refineries and exports any excess not used locally. Approximately 60% of crude oil production is used in the domestic refinery market, and the balance is exported.

In 2007, Colombia's crude reserves continued declining after reversing its declining trend in 2006. As of Dec. 31, 2007, Colombia's proved conventional oil and gas reserves totaled 2.54 billion barrels, yielding a proved crude oil reserve life of approximately seven years. In 2007, Ecopetrol reported a slight decrease in reserves after reporting 1.21 billion reserves (down 3.4% from the 1.25 billion reserves reported a year earlier) at year end according to the U.S. Securities and Exchange Commission's (SEC) methodology. The company's proved reserves are determined in accordance with the criteria and methodology of the World Petroleum Congresses (WPC) and the Society of Petroleum Engineers (SPE). These groups focused their analyses on the estimation, based on reasonable certainty, that the underlying proved hydrocarbon reserves were commercially recoverable.

Ecopetrol's capital expenditure program is largely earmarked for exploratory and exploitation activities and so far has resulted in an increase in the company's reserves and production. Ecopetrol's firm investment in E&P is forecasted to increase to between USD1.5 billion and USD2 billion per year going forward for total projected E&P capital expenditures of USD11 billion over the next seven years. This is aimed to increase oil and gas reserves and production.

In Colombia, a new exploratory cycle has begun. Between 2006 and September 2008 there were 201 exploratory wells drilled in the country. The company's near-term strategy is expected to be focused on activities near existing producing



projects with relatively lower levels of risk. For larger, riskier projects, Ecopetrol is looking to participate in partnerships, as is the case with ExxonMobil Corporation and Petróleo Brasileiro S.A. (Petrobras) in the Tayrona block. Ecopetrol has participated in bidding processes in Brazil and Peru. Ecopetrol, in association with other companies, was awarded six blocks in Brazil and nine in Peru.

The country's crude oil production reversed its declining trend in 2007 as a result of high oil prices, which made non-profitable fields profitable. Concurrently, the country's initiative to increase production by awarding more exploratory field aided reversing the declining oil production trend. In 2007, total crude production in the country was approximately 531,000 boe/d, slightly up from 529,000 boe/d in 2006, yet still down from 578,000 boe/d in 2002. In 2007, Ecopetrol produced approximately 327,000 bpd of crude oil, while 204,000 bpd was produced by other companies. Much of Colombia's crude oil is lighter and sweeter than that of other major Latin American oil producers. Ecopetrol's 2007 crude production, akin to that of the rest of the country, was approximately 75% in light and medium crudes, and the balance was heavy crude.

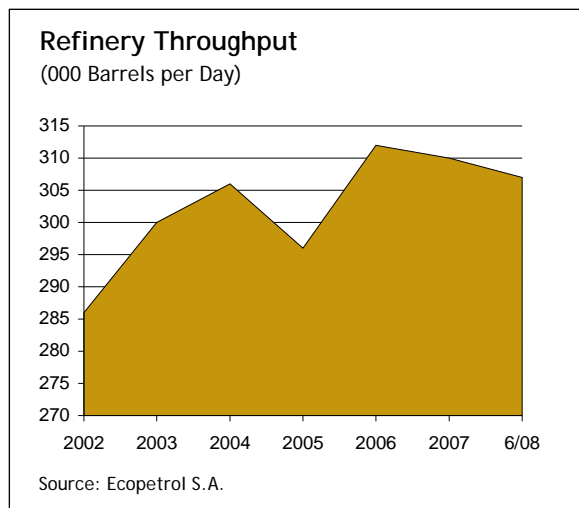
During 2007, Colombia's total crude production was used by the domestic refineries (approximately 310,000 bpd), and exported by Ecopetrol and associated producers (80,000 bpd and 140,000 bpd, respectively).

Similar to most oil companies, Ecopetrol's mean lifting cost continues to increase, and in 2007 averaged an estimated USD7.24 per boe. While expenses associated with gas injection and extending the life of certain fields are expected to result in higher average lifting costs in the coming years, the company's production cost structure remains competitive.

Colombia's natural gas reserves currently total 7 trillion cubic feet, with production of 935 million cubic feet per day as of September 2008. Ecopetrol's gas reserves currently amount to 3.2 trillion cubic feet, and production during 2007 averaged 412 million cubic feet per day, which the company sold at an average price of approximately USD1.98 per million Btu. The company's average lifting costs of natural gas during 2007 was USD0.21 per thousand cubic feet. An estimated 40% of the total gas output is associated with crude oil production. Ecopetrol's business plan includes additional natural gas development, though recent development has been slow. The reduction of gasoline and diesel subsidies was established to help increase natural vehicular gas consumption and alleviate pressures on oil production, as formalized in the Consejo Nacional de Política Económica y Social (CONPES) document, which establishes the country's economic and development policies. Ecopetrol is looking to develop the domestic gas market and turn toward neighboring countries for natural gas export opportunities.

Downstream Operations

The company owns 87% of Colombia's refining capacity. Downstream operations encompass two major domestic refineries with a combined installed capacity of 330,000 bpd, Barrancabermeja (250,000 bpd) and Cartagena (80,000 bpd). During 2007, throughput at Ecopetrol's refineries was 309,920 bpd. During the first half of 2008, Ecopetrol refineries'



throughput was approximately 307,000 bpd, with Barrancabermeja contributing 229,000 bpd and Cartagena contributing 77,000 bpd. As of June 30, 2008, Ecopetrol refineries' cracking spread declined to USD1.61 per barrel from USD10.6 per barrel at year-end 2007.

Ecopetrol and the Cartagena refinery currently supply 100% and 96% of the national gasoline and diesel demand, respectively. The national fuel demand composition continues to change, with demand for gasoline declining and that for diesel increasing. The decrease in gasoline demand is mainly due to the conversion of public-service vehicles to natural gas, the higher use of ethanol-mix gasoline and the lower overall demand for gasoline due to subsidies reduction. Higher diesel demand is mostly driven by the country's massive transportation systems and subsidized diesel price. Ecopetrol expects this trend to continue going forward. The company expects to increase diesel production with lower sulfur content.

Ecopetrol's export strategy aims to export to the most profitable markets under medium-term contracts, reducing the company's exposure to the spot market. Crude exports have increased in recent years with the Castilla blend, the most exported crude. Refined product exports have declined mainly due to higher national diesel demand.

The most significant project currently under development is the Plan Maestro de Desarrollo (PMD) of the Cartagena refinery, which is expected to increase refining capacity to 150,000 bpd from approximately 80,000 bpd and increase conversion capacity to 94%. It is expected to be commissioned in early 2010. In addition, the Cartagena PMD expects to increase the refinery capacity to produce better quality fuels. Total investment for this project is expected to be approximately USD2.4 billion and to be financed 51% by Glencore and 49% by Ecopetrol.

The second project is the addition of a hydro treating unit at the Barrancabermeja refinery to reduce sulfur content in diesel and gasoline output. This project is estimated to cost USD500 million.

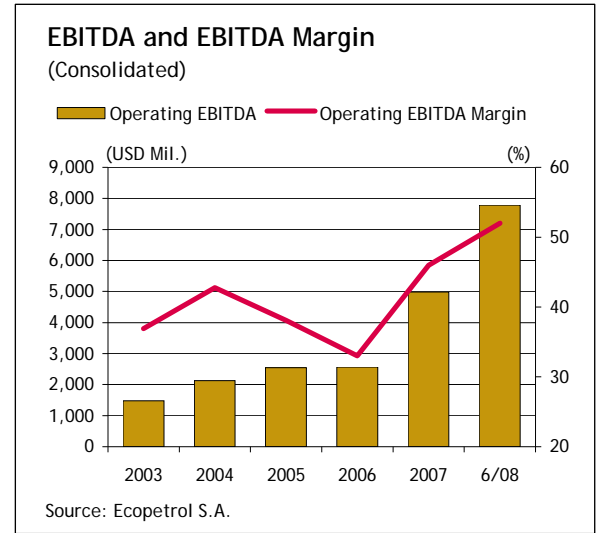
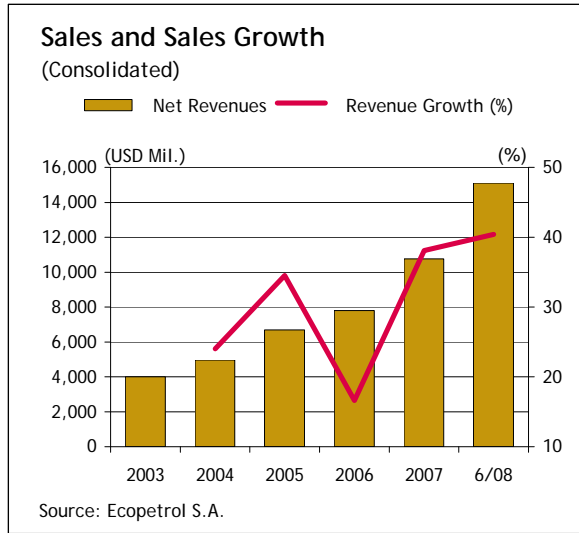
These two projects will give Ecopetrol a competitive edge, as the company will be able to offer a product that meets stricter environmental requirements. They will also increase Ecopetrol's throughput, decreasing Colombia's dependency on imported fuel.

Financial Profile

Ecopetrol's financial profile is considered very strong, with steadily growing revenues, strong operational margins and no financial debt. Ecopetrol reported fiscal year-end 2007 revenues of COP22.3 trillion, an increase from COP18.4 trillion in 2006, reflecting higher international energy and product prices. EBITDA for 2007 was COP10.4 trillion versus COP6.1 trillion in 2006 due to higher revenues, the implementation of an internal organizational restructuring plan, increased refining margins and continued fuel theft reduction.

The company's main costs are directly related to oil and gas production as well as royalties to the Colombian government. Royalties represent the payments for the depletion of government-owned, nonrenewable natural resources.

Ecopetrol commercializes the production from its direct operations and under association agreements that were originated prior to Dec. 31, 2003. With Decree 1760 introduced in 2003, this function was transferred to the ANH for contracts originated on Jan. 1, 2004, and thereafter.



Royalties and other hydrocarbon purchases to ANH from Ecopetrol amounted to approximately COP3.9 trillion as of December 2007, accounting for 28.9% of total company costs. As of year-end 2007, Ecopetrol's net income was COP5.2 trillion. Ecopetrol's transfers to the government amounted to approximately COP12.5 trillion, which was represented by dividends (COP4.5 trillion), production royalties (COP3.9 trillion) and taxes (COP4.0 trillion).

EBITDA to interest coverage should remain strong, given the company's conservative capital structure and relatively low debt levels. Going forward, the natural gas business is expected to be a larger contributor to Ecopetrol's operations as new markets, domestically and internationally, are opening for the use of the existing gas reserves.

Ecopetrol's pension liabilities are not considered a major concern for the company's credit profile due to the meaningful steps taken by Ecopetrol to address the situation. The company is responsible for the pension liabilities of all employees that have been with Ecopetrol prior to 1990. As of December 31, 2007, the company's unfunded pension liabilities were approximately USD660 million, or approximately 12% of total pension liabilities.

Ecopetrol's future capital expenses will average between USD8.5 billion and USD9 billion per year during the next seven years. The company expects to finance this very aggressive growth strategy by using internal cash flow generation during this period, estimated by the company to be approximately USD33.5 billion. The company would also issue approximately USD10 billion to USD20 billion of debt, possibly on and off balance sheet, and do a second equity public offering to raise an estimated USD6.4 billion. This last transaction would further capitalize the company and dilute the government's total capital position in the company from its current 89.9% to 80%.

Financial Summary — Ecopetrol S.A.

(USD Mil., Years Ended Dec. 31)

	1,913.50	2,018.00	2,238.79	2,284.22	2,389.75
	1,934.90	2,075.16	2,359.68	2,321.10	2,627.71
	LTM				
	6/30/08	2007	2006	2005	2004
Profitability					
Operating EBITDA	7,788	4,980	2,570	2,549	2,126
Operating EBITDA Margin (%)	52	46	33	38	43
Funds from Operations (FFO) Return on Adjusted Capital (%)	(13)	19	17	11	29
Free Cash Flow (FCF) Margin (%)	(15)	(11)	0	(0)	(1)
Return on Average Equity (%)	37	22	19	28	21
Coverage (x)					
FFO Interest Coverage	382.3	—	204.0	67.1	107.2
Operating EBITDA/Interest Expense	(1,547.4)	—	356.7	279.0	202.1
Operating EBITDA/Debt-Service Coverage	(1,547.3)	2,815.8	97.5	48.0	39.6
FFO Fixed-Charge Coverage	382.3	—	204.0	67.1	107.2
FCF Debt-Service Coverage	460.0	(651.4)	1.2	—	(0.9)
(FCF + Cash and Marketable Securities)/Debt-Service Coverage	128.0	399.2	29.0	5.9	0.5
Cash Flow from Operations/Capital Expenditures	(0.5)	1.7	2.1	2.0	1.7
Capital Structure and Leverage (x)					
FFO Adjusted Leverage	—	—	—	0.1	0.1
Total Debt with Equity Credit/Operating EBITDA	—	—	—	—	—
Total Net Debt with Equity Credit/Operating EBITDA	(0.2)	(0.4)	(0.3)	(0.1)	—
Implied Cost of Funds (%)	—	—	15.6	10.6	9.3
Secured Debt/Total Debt	—	—	—	—	—
Short-Term Debt/Total Debt	—	1.0	1.0	0.6	0.4
Balance Sheet					
Total Assets	28,932	23,841	18,822	14,300	11,702
Cash and Marketable Securities	1,660	1,858	727	316	76
Short-Term Debt	—	2	19	44	43
Long-Term Debt	—	—	—	27	56
Total Debt	—	2	19	71	99
Total Equity	14,773	13,285	9,307	5,816	4,185
Total Adjusted Capital	14,773	13,287	9,326	5,887	4,284
Cash Flow					
Funds from Operations	(1,919)	2,496	1,462	604	1,117
Change in Operating Working Capital	1,132	—	224	486	(157)
Cash Flow from Operations	(787)	2,496	1,686	1,090	960
Total Non-Operating/Non-Recurring Cash Flow	—	—	—	—	—
Capital Expenditures	(1,508)	(1,492)	(815)	(541)	(581)
Dividends	—	(2,157)	(848)	(559)	(441)
Free Cash Flow	(2,295)	(1,152)	24	(10)	(61)
Net Acquisitions and Divestitures	(2,570)	(2,423)	(986)	(213)	(48)
Other Investments, Net	—	—	—	—	—
Net Debt Proceeds	2	(19)	(51)	(32)	(55)
Net Equity Proceeds	2,547	2,583	1,006	580	173
Other Financing, Net	(20)	(1)	(33)	(92)	(16)
Total Change in Cash	(153)	1,023	(39)	233	(8)
Income Statement					
Net Revenues	15,110	10,762	7,793	6,683	4,967
Revenue Growth (%)	40.4	38.1	16.6	35	—
Operating EBIT	6,715	4,234	2,015	1,952	1,497
Gross Interest Expense	(5)	—	7	9	11
Rental Expense	—	—	—	—	—
Net Income	4,541	2,496	1,437	1,402	803

LTM – Last 12 months.

Source: Fitch Ratings.

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