

RATING ACTION COMMENTARY

Fitch Affirms Ecopetrol's Foreign and Local Currency IDRs at 'BB+'; Outlook Stable

Thu 17 Nov, 2022 - 1:16 p.m. ET

Fitch Ratings - New York/Bogota - 17 Nov 2022: Fitch Ratings has affirmed Ecopetrol S.A.'s Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) at 'BB+'. The Rating Outlook for the IDRs is Stable. Fitch has also affirmed the company's National Long- and Short-Term ratings at 'AAA(col)'/ 'F1+(col)'. The Rating Outlook for the National Long-Term rating is Stable.

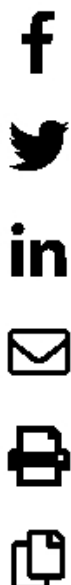
Ecopetrol's ratings reflect the close linkage with the Republic of Colombia (Foreign and Local Currency IDRs BB+/Stable), which currently owns 88.5% of the company.

Ecopetrol's ratings also reflect the company's strategic importance for the country, as well as its ability to maintain a solid financial profile.

KEY RATING DRIVERS

Linkage to Sovereign: Ecopetrol's ratings reflect the strong linkage between the credit profile of the Republic of Colombia, which owns 88.5% of the company's total capital. The ratings also reflect the very strong incentives of the Colombian government to support Ecopetrol in the event of financial distress, given the company's strategic importance to the country, as it supplies virtually all liquid fuel demand in Colombia, and owns 100% of the country's refining capacity. The company relies on the receipt of funds from the Colombian government, through its stabilization fund Fondo de Estabilizacion de Precios de los Combustibles (FEPC), to offset the difference from selling fuel in the local market at lower prices versus the export market.

At September 2022, the amount accrued in the FEPC was COP 20.4 trillion (USD \$5 billion). As the Colombian government continues to increase retail prices of fuel, Fitch expects that the balance in the FEPC account will decrease. So far, the price has been adjusted by COP 400/gallon, and further increases are expected in the next six months.



Deconsolidated with ISA: Fitch expects that the majority of Ecopetrol's consolidated EBITDA will continue to be generated from its energy business. Fitch estimates that on a deconsolidated basis, ISA's EBITDA in 2022 adjusted to Ecopetrol's ownership, is expected to represent 5.1% of Fitch's projected Ecopetrol EBITDA for 2022. Thus, currently, the ISA acquisition is not expected to materially impact Ecopetrol's leverage metrics over the rated horizon.

Fitch estimates that consolidated pro forma gross leverage, defined as total debt to EBITDA, will be low during the rating horizon at 1.0x for FYE 2022, and 1.2x on average through 2026. Pro forma for ISA's debt and EBITDA, leverage in 2022 increases to 1.5x in 2022 and averages 2.1x through the rating horizon.

Strong Financial Profile: Ecopetrol's 'bbb' Standalone Credit Profile (SCP) reflects the company's strong financial profile. Fitch calculated gross leverage as measured by total debt to EBITDA decreased to 2.4x in 2021 from approximately 2.9x at YE 2020. Fitch expects leverage to continue to be low though the rating profile as Brent process continue supporting EBITDA generation, and debt is expected to remain at current levels. Fitch expects Ecopetrol's interest coverage as measured by EBITDA to interest expense coverage to exceed 20x consistently through the rating horizon.

Positive FCF Expected: Fitch expects Ecopetrol's FCF to be positive going forward, subject to revisions to investment and dividends plans. Fitch's base case assumption includes the company having an average annual capex budget of approximately USD5.0 billion over the next three years, and that it will pay 60% of previous year's net income in line with its 40% to 60% dividend policy. This, coupled with Fitch's price assumptions for Brent crude oil price of USD100/bbl in 2022, USD85/bbl in 2023, and USD53/bbl in the long term, would result in positive FCF over the next three years.

Stable Operating Metrics: After production cuts of 4% implemented in 2020, and subsequent 6% reduction in reserves resulting from lower global hydrocarbon prices, Ecopetrol's operating metrics have recovered and are well underway to reach pre-pandemic levels.

Fitch assumes total hydrocarbons production to be 704 thousand barrels of oil equivalent per day (boe/d) in 2022 exhibiting a trend or recovery expected to continue over the next three years. The company's proved reserve (1P) of 2,002 million boe gave the company a reserve life of 9.0 years as of 2021. Fitch assumes a 105% reserve replacement rate.

Ecopetrol's leverage, as measured by total debt/proved reserves was USD7.5/boe as of YE 2021 (this including ISA debt), and lowered than previously forecasted at USD10/boe for YE 2021 as a portion of the debt was repaid during the year and reserves increased by 95 MM boe. Fitch's calculated implied pretax break-even crude oil price for Ecopetrol has remained relatively stable over the past three years at approximately USD38/boe.

DERIVATION SUMMARY

Ecopetrol's rating linkage to the Colombian sovereign ratings is in line with the linkage present for most national oil and gas companies (NOCs) in the region; including Petroleos Mexicanos (Pemex; BB-/Stable), Petroleo Brasileiro S.A. (Petrobras; BB-/Stable), Petroperu S.A. (BB+/Negative) and Empresa Nacional del Petroleo (A-/Stable).

In most cases in the region, NOCs are of significant strategic importance for energy supply to the countries where they operate, as is the case in Mexico, Colombia and Brazil. NOCs can also serve as a proxy for federal government funding as in Mexico, and have strong legal ties to governments through their majority ownership, strong control, and governmental budgetary approvals.

Ecopetrol's SCP is commensurate with a 'bbb' rating, which is in line with that of Petrobras at 'bbb' given Petrobras' recent significant debt reduction. Excluding IFRS16 leases, Ecopetrol's leverage as of in year-end 2021 was 3.1x. Ecopetrol's credit profile is materially higher than that of Pemex 'ccc-' SCP as a result of Ecopetrol's deleveraging capital structure versus Pemex increasing leverage trajectory. Ecopetrol will continue reporting a stable production, which Fitch expects to stabilize around 700,000boe/d. This production trajectory further supports the notching differential between the two companies' SCP.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within the Rating Case for the Issuer:

- Ecopetrol remains majority owned by Colombia;
- Brent average USD100/bbl in 2022 and USD85/bbl in 2023 before trending toward USD53/bbl in the long term;
- USD 15bbl discount to Brent;
- Stable production growth of 2% per annum between 2022 through 2024;
- 105% reserve replacement ratio per year;
- Aggregate capex of approximately USD5.0 billion per year for the next three years;
- Dividends of 60% of previous year's net income.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Although not expected in the short- to medium term, an upgrade of Colombia's sovereign ratings.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--A downgrade of Colombia's sovereign ratings;

--A significant weakening of the company's linkage with the government and a lower government incentive to support couple with a deterioration of its standalone credit profile.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

LIQUIDITY AND DEBT STRUCTURE

Strong Liquidity: Ecopetrol's strong liquidity profile is supported by cash on hand, strong access to the capital markets and an adequate debt maturity profile. Ecopetrol reported COP 13 trillion (USD3.2 billion) of cash and equivalents on hand in Sept. 30, 2022 compared with roughly USD3.5 B of principal maturities due in 2022 and 2023 and the USD774 million of debt service over the same period of time. The company utilized its USD1.2 billion committed credit line in September 2022, in order to repay a portion of the debt associated with the acquisition of ISA.

ISSUER PROFILE

Ecopetrol is a leading integrated energy and infrastructure company in the Latin American and Central American region. The company is the largest in Colombia in relation to their Upstream, Midstream, and Downstream business segments, and the company is the largest energy transmission company in region in connection with the Interconexión Eléctrica S.A. acquisition.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

Ecopetrol S.A.'s LT IDR is linked to the sovereign rating of Colombia.

ESG CONSIDERATIONS

Ecopetrol S.A. has an ESG Relevance Score of '4' for Governance Structure due to its

nature as a majority government-owned entity and the inherent governance risk that arise with a dominant state shareholder, which has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

Ecopetrol S.A. has an ESG Relevance Score of '4' for Exposure to Social Impacts due to multiple attacks to its pipelines, which has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Ecopetrol S.A.	LT IDR	BB+ ●	Affirmed	BB+ ●
	LC LT IDR	BB+ ●	Affirmed	BB+ ●
	Natl LT	AAA(col) ●	Affirmed	AAA(col) ●
	Natl ST	F1+(col)	Affirmed	F1+(col)

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APPLICABLE CRITERIA

APPLICABLE CRITERIA

[Government-Related Entities Rating Criteria \(pub. 30 Sep 2020\)](#)

[Metodología de Calificación de Entidades Relacionadas con el Gobierno \(pub. 12 Nov 2020\)](#)

[National Scale Rating Criteria \(pub. 22 Dec 2020\)](#)

[Metodología de Calificaciones en Escala Nacional \(pub. 22 Dec 2020\)](#)

[Parent and Subsidiary Linkage Rating Criteria \(pub. 01 Dec 2021\)](#)

[Metodología de Calificación de Finanzas Corporativas \(pub. 02 Dec 2021\)](#)

[Corporate Rating Criteria \(pub. 28 Oct 2022\) \(including rating assumption sensitivity\)](#)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 [\(1\)](#)

ADDITIONAL DISCLOSURES

[Dodd-Frank Rating Information Disclosure Form](#)

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ENDORSEMENT STATUS

Ecopetrol S.A. EU Endorsed, UK Endorsed

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[Latin American Corporate Credit Insights \(Sector Credit Trends to Watch in 2022\)](#)

[What Investors Want to Know: Latin American Energy \(Heightened Political Risk Challenges Profitability and Progress\)](#)

Fitch LATAM Top 10 WIWTK Series: Latam Energy

[Ecopetrol S.A.](#)

Latam Oil & Gas Outlook to Stabilize in 2022 Following Strong Price Recovery

[Fitch Ratings 2022 Outlook: Latin American Energy \(Oil & Gas\)](#)

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[EMEA Natural Resources & Commodities Rating Trends Dashboard: 3Q22](#)

Balance of Outlooks Returns to Pre-Covid Level for EMEA Commodities Portfolio

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Fitch Upgrades AstraZeneca's IDR to 'A-'; Outlook Stable

Fitch Upgrades Enerna to 'BBB+', Removes from Rating Watch Positive; Outlook Stable

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RATINGS KEY

POSITIVE

NEGATIVE

EVOLVING

STABLE

OUTLOOK



WATCH



* Long Term/Short Term Issuer Default Rating displayed in orange denotes EU or UK Unsolicited and Non-Participatory Ratings

Where there was a review with no rating action (Review – No Action), please refer to the “Latest Rating Action Commentary” for an explanation of key rating drivers

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