INTER-AMERICAN DIALOGUE'S
LATIN AMERICA ADVISOR ▸ ENERGY

FEATURED Q&A

How Well Is Colombia's Ecopetrol Performing?

Q A year ago, Colombia's Ecopetrol overtook Brazil's Petrobras as the largest listed energy company in Latin America by market capitalization, but its market cap has fallen by around 40 percent since then, and last month Ecopetrol reported that net profit in 2013 was down 10.8 percent year-on-year. Despite that, CEO Javier Gutiérrez said 2013 was a good year for the company, noting that it "grew our reserves and production and maintained strong financial results within a challenging environment for our operations." How did Ecopetrol fare in 2013? What is the outlook for the company this year? What are its challenges, and what is going well?

A David Ross, managing director of Chevy Chase Trust Investment Advisors in Bethesda, Md.: "Ecopetrol, as demonstrated by its falling market capitalization, has failed over the last 18 months to build on its past success. Production growth, the company's hallmark by growing at a compound annual growth rate of 13.6 percent during 2007-2012, slowed to 4.5 percent in 2013 and even fell in the last quarter from the previous quarter. In addition to slowing production, the company has failed to significantly build reserves. While the company was able to boost reserves at the end of 2013 to maintain a Reserve Life Index of eight years, this was almost entirely (90 percent) due to revisions and extensions, not discoveries. To the outside investor, Ecopetrol, often referred to as a 'law firm with oil rigs,' appears to be more interested in satisfying the agenda of its main shareholder, the Colombian government (88.5 percent) than in maximizing shareholder value. While the government's budget benefits from a high dividend, the company's payout ratio of 80 percent has hampered its ability to adequately fund its capital expenditure budget, to the detriment of exploration success. Not only has

Continued on page 3

Pemex To Invest Record Sum of $28 Billion This Year

Mexican state oil company Pemex will invest a record sum of nearly $28 billion this year, most of which will be earmarked for exploration and production, CEO Emilio Lozoya said Monday. See story on page 2.

File Photo: Mexican Government.

Inside This Issue

ENERGY SECTOR BRIEFS

Atacama Solar's 3 MW Los Puquios Solar Plant Begins Operating in Chile

Atacama Solar's 3-megawatt Los Puquios solar plant in Chile's northern Tarapacá region has begun operating, the company, which is comprised of approximately 30 Spanish investors, said in a statement, EFE reported Tuesday. The $3.9 million plant is the largest fixed-solar power station in Chile, according to the company, which added that Chile has among the world's highest potentials for photovoltaic stations.

Sowitec to Carry Out Feasibility Study for 40 MW Solar Plant in Peru

Peru's Ministry of Energy and Mines on Monday granted a temporary concession to **Sowitec Operation Perú** to carry out feasibility studies for a 40-megawatt solar plant in the La Joya district of Arequipa province, state news agency Andina reported. The company presented an application for the concession on Dec. 5 and will have 24 months beginning Tuesday to complete the studies.

Bolivia Natural Gas Sales Increased 11.9 Percent Year-on-Year in 2013

Bolivia received $6.06 billion of revenue last year from the sale of natural gas to Argentina and Brazil, an 11.9 percent increase from the $5.4 billion revenue earned in 2012, state-owned **YPFB** said in a statement Feb. 27. YPFB's director of natural gas, Juan Sosa, said preparations for the World Cup and low levels of water at the country's hydroelectric plants increased demand in Brazil. In December, Bolivia consumed 9.69 million cubic meters of natural gas per day (cmd) domestically and exported an average of 32.16 cmd to Brazil and 14.55 cmd to Argentina.

Oil & Gas News

Pemex Contractor Oceanografía Under Investigation for Fraud

Bondholders of **Oceanografía**, a contractor for Mexican state-owned oil company **Pemex**, on Wednesday took control of a 180-meter construction ship as collateral after determining that the company was in default on $160 million of notes due in 2018 because of a missed payment, Bloomberg News reported. On Feb. 28, the Mexican government took over the oil-services company after **Citigroup** reported finding at least $400 million in bogus loans from Oceanografía at its Mexican unit, Bloomberg News reported. Citigroup's chief executive officer, Michael Corbat, said Citi believes the incident was an isolated one and called it a "despicable crime." Oceanografía borrowed from **Banamex** listing anticipated payments from Pemex as collateral. However, Banamex recently learned that Oceanografía seemed to have falsified invoices to the state oil company, Corbat told employees in a separate memo. Pemex on Feb. 11 took action to suspend Oceanografía from receiving government contracts for 21 months and 12 days. The suspension is a major blow to Oceanografía, which derives some 97 percent of its revenue from Pemex. Between 2003 and 2013, Oceanografía received nearly $3 billion through more than 100 contracts with the state oil company. On Feb. 28, Mexico's attorney general's office said it was investigating the oil services provider and announced that it had seized its assets. Mexico's government also named an administrator to salvage whatever business remains. "The attorney general's office is working along with financial authorities and the bank in order to establish criminal responsibility quickly," Attorney General Jesús Murillo Karam said last week. Officials in Mexico have previously raised questions about Oceanografía. The country's Federal Audit Office criticized Pemex in 2012 for what it said was a failure to investigate apparent contract irregularities with the oil services provider. Pemex also did not properly investigate overpayments for work that was not happening on time, the audit office said at the time. However, Pemex did not sanction Oceanografía until Feb. 11, leading to Citigroup's investigation of Banamex's loans to the company.

> "The attorney general's office is working ...to establish criminal responsibility quickly."
>
> *— Jesús Murillo Karam*

U.S. Judge Rules That Judgment Against Chevron Was Fraudulent

The legal team representing Ecuadorean villagers in a pollution case against **Chevron** used "corrupt means" to secure a multi-billion dollar judgment through a court in Ecuador in 2011, U.S. District Court Judge Lewis Kaplan in New York ruled Tuesday, BBC News reported. The ruling means that the villagers cannot turn to U.S. courts to enforce the ruling, but the Ecuadoreans' legal team said it will appeal. An Ecuadorean judge in 2011 ruled that Chevron should pay residents of the Lago Agrio region $18.2 billion for "extensively polluting" the region. Last year, the nation's supreme court upheld the ruling, but reduced the compensation awarded to $9.5 billion. The legal battle is over contamination that occurred at a **Texaco**-operated oil field in Ecuador between 1964 and 1992. Chevron purchased Texaco in 2001 and says that it cleaned up its share of the pollution before turning the field over to Ecuador's state-oil company **Petroecuador.** Kaplan said there was "clear and convincing evidence" that lawyer Steven Donziger had used bribes and coercion to secure a ruling in favor of the villagers, according to Reuters. Donziger called Tuesday's decision "appalling." Chevron is expected to use Kaplan's decisions to challenge other claims against it abroad.

Pemex Plans to Invest a Record $28 Billion This Year

Mexican state oil company **Pemex** will invest a record sum of nearly $28 billion this year, most of which will be earmarked for exploration and production, EFE reported. Speaking at an energy conference in Los Cabos on Monday, Pemex CEO Emilio Lozoya said, "This year, Pemex will invest the historic figure of almost $28 billion, 85 percent in exploration and production of crude oil and gas." Of the overall figure, $3.2 billion will go to refining activities. The $27.7 billion that Pemex plans to invest during 2014 represents a 6.5 increase over investment last year and a 154.1 percent increase from a decade ago, the company said on its Web site, according to EFE, and Pemex foresees increasing investment to $31.8 billion in 2018, the *Financial Times* reported. However, "to develop the full potential of resources in the country will require investment of more than $60 billion a year," Lozoya added, according to the company's Twitter. Pemex is the fifth-largest producer of oil in the world, but output has stagnated over the last five years, the *Financial Times* reported. Pemex's output last year averaged 2.52 million barrels of crude per day, a figure that is expected to remain the same this year and which represents a nearly 1 million barrel decrease from peak output a decade ago. On Monday, Lozoya also touted opportunities for foreign investors in the sector, noting that after the country's energy reforms "There will be important opportunities both for Pemex and for other participants in an open market," EFE reported. By March 21, Pemex has to file to regulators a list of priority blocks and regions for exploration and production based on "financial ability," "competitive advantages" and other factors, said CFO Mario Alberto Beauregard.

Lozoya

File Photo: Pemex.

U.S. High Court Orders Argentina to Pay Britain's BG Group $185 Mn

The U.S. Supreme Court ruled Wednesday that Argentina must pay British oil and gas company **BG Group** $185.3 million for losses the company incurred due to a 2002 gas-price freeze that occurred soon after the South American country defaulted on

Featured Q&A

Continued from page 1

the company been stingy in its capital expenditures, but a large amount has been directed toward downstream assets like refining. For Ecopetrol, the downstream division is not profitable and yet they have allocated billions of dollars to upgrading their refineries, even as U.S. refineries, with their cost advantage, are squeezing margins globally. In a world short of heavy oil due to Venezuela's production declines, investors would prefer seeing capex aggressively allocated toward a successful exploration program to ensure the company's future."

A Luis E. Giusti L., member of the *Energy Advisor* board, senior advisor at the Center for Strategic and International Studies and former chairman and CEO of PDVSA: "By just looking at the numbers it becomes clear that Ecopetrol had good results in 2013. Through a total investment of $3.73 billion in exploration and production, the company increased its production to a historic record of 788,200 barrels per day of oil equivalent and increased P1 reserves by 5.1 percent to a new total of 1.972 billion barrels of oil equivalent. This translated into a healthy 139 percent reserves replacement factor. In addition, it invested $350 million in upgrading its Cartagena Refinery, preparing it for an efficient supply of products to the domestic market and leaving capacity for a volume of exports. Add new alliances nationally and internationally, a strong cash position and a reasonable debt-to-equity ratio, and 2013 was indeed a good year. In 2012, Ecopetrol overtook Petrobras in terms of market value, partly because the latter had two years of $50 billion to $60 billion budgets without significant production growth, while the OGX fall from grace was not helping the Brazilian oil investment climate. In the meantime, Colombia was the Latin American vedette, and its national oil company was still enjoying the benefits of growth and recent partial privatization and internationalization. It is widely understood that capital can move fast to find security and good returns. In 2013, the Colombian oil industry was afflicted by delays in approval of environmental licenses for oilfield operations, and although not severe, a resurgence of violence, which have affected in some degree the market cap of almost every oil company operating in Colombia with an equity position in public markets."

A Rodrigo Villamizar, former Colombian minister of mines and energy and professor at the Instituto de Estudios Bursátiles at the Universidad Complutense in Madrid and the University of San Diego: "Ecopetrol's greatest problem is declining reserves. The official goal of growth in production of 1 million barrels per day by 2015 requires an addition to reserves higher than what the company has achieved so far. Today, Ecopetrol has only 8.1 years worth of reserves. A 40 percent decrease in the stock price in an election year doesn't look like a promising run for Ecopetrol. Perhaps the peso's slump could prove to be a blessing since Ecopetrol generates more than two-thirds of its revenues from oil exports. This, of course, requires that prices don't fall due to pressure from increased production in the United States and the new Iranian oil coming on stream. Colombia's strong resource base and business-friendly policies could offset some of the headwinds against the company but not its fundamentals. And those are more closely related to geology than to geopolitics. Financial metrics like net debt/EBITDA, EBITDA margin and ROA present a bright side of Ecopetrol when compared with some of the majors, such as Petrobras, BP and Exxon. It has increased production consistently (meaning higher efficiency and investment in midstream). It's clearly one of the best-performing energy groups until you check its fuel tank. Its market capitalization has risen impressively, even briefly surpassing that of Petrobras, the Brazilian major which produces about three times as much oil. In the oil world nothing scares more than when the variation in output growth is higher than the variation in the

Continued on page 6

its international debt at the end of 2001, *The Telegraph* reported. BG Group, which held the largest stake in gas distributor **Metrogas** at the time, initially sought arbitration in 2003 after the government unilaterally changed the basis of prices from U.S. dollars to pesos and froze prices, contending that the move had reduced the value of its stake in the distributor. The dispute centers on the interpretation of a British-Argentine investment treaty. A U.S.-based tribunal and federal district court had previously ruled in BG Group's favor, but in 2012, an appeals court in Washington threw out the $185 million arbitration award, ruling that per the terms of the treaty, the dispute should have been handled in an Argentine court first. However, the Supreme Court found that circumstances had rendered the local litigation requirement inapplicable because Argentina had enacted "new laws that hindered recourse to its judiciary by firms in BG Group's situation," according to EFE.

Petrobras to Explore for Hydrocarbons in Eastern Bolivia

Brazilian state oil company **Petrobras** will explore for hydrocarbons in eastern Bolivia, national oil company **Yacimientos Petrolíferos Fiscales Bolivianos** announced, the Associated Press reported Monday. YPFB president Carlos Villegas and **Petrobras Bolivia** head Erick Portela signed a contract on Sunday, paving the way for exploration in the 99,775-hectare (246,358-acre) Cedro area in the gas-rich southeastern province of Santa Cruz. "In the next few days, the Brazilian oil company will present its work plan and budget to YPFB," YPFB said, according to EFE. Petrobras already has exploration and production contracts for seven areas in Bolivia. Petrobras produces gas for export to Brazil, where demand averages 31 million metric tons per day.

Announcement

Mary Rose Brusewitz Joins the Board of Advisors

We are pleased to announce that Mary Rose Brusewitz, partner in charge of the New York office of **Strasburger & Price** and chair of the firm's international practice, has joined the *Energy Advisor*'s board.

Brusewitz has more than 30 years of experience as a transactional attorney, with a focus on working with Latin American, as well as U.S, European and Asian companies doing business in Latin America. Her areas of expertise include evaluating legal and regulatory systems, cross-border investments and joint ventures and emerging markets development finance, including in the infrastructure, water, power, oil and gas, renewable energy, mining and roads sectors. Brusewitz also works in areas of impact investing and sustainability accountability and works with the microfinance industry on carbon trading and climate change-related issues.

Her past experience includes working on project financing, acquisition and disposition, and restructuring transactions for offshore oil field development, gas and oil pipeline deals, and thermal, hydro and wind projects. She has also advised on proposed energy policy legislation and has experience in the cross-border lease financing of large assets, such as offshore oil rigs and platforms.

Brusewitz speaks Spanish and Portuguese and is a panel member of the Independent Consultation and Investigation Mechanism of the Inter-American Development Bank, a transparency forum. She also serves on the board of the Microfinance Club of New York and was named to the 2009, 2010 and 2013 editions of The International Who's Who of Oil & Gas Lawyers. Brusewitz holds a B.A. from the University of California, Los Angeles and a J.D. from the UCLA School of Law.

Power Sector News

Enel to Begin Studying Feasibility of Geothermal Plant in Guatemala

Guatemala's Ministry of Energy and Mines on Wednesday authorized renewable energy company **Enel Guatemala** to begin feasibility studies and surveys with the goal of installing a geothermal plant in the department of Totonicapán, *Prensa Libre* reported. The company has one year to explore and carry out studies on the feasibility of generation, transportation and distribution from an eventual Central Generadora Palá plant. Enel is authorized to carry out studies in the municipalities of Momostenango, Santa María Chiquimula, San Bartolo Aguas Calientes, San Francisco el Alto and the department's capital, Totonicapán. The energy ministry foresees holding a tender for a geothermal plant to generate 150 megawatts of energy and begin operation in 2016. The Central American nation currently has two installed geothermal plants with a total capacity of approximately 50 megawatts. In late January, Nevada-based **Ormat Technologies** signed an agreement with state utility **Instituto Nacional de Electrificación** (INDE) to extend its power-purchase agreement from the Zunil geothermal plant for 15 years, from 2019 to 2034. The contract amendment also transferred operation and management of the geothermal field to Ormat in exchange for an increased energy tariff, and INDE took a three percent stake in the project, Ormat said in a statement. Ormat added that it will work to improve the heat supply to increase the plant's generation, which is currently working at about 50 percent of installed capacity.

Political News

Araya Drops Out of Costa Rica Presidential Race

Ruling party candidate Johnny Araya on

Wednesday withdrew from Costa Rica's presidential race, virtually guaranteeing that opposition candidate Luis Guillermo Solís will be elected in the country's April 6 runoff. Araya, of the National Liberation Party, made the announcement after the University of Costa Rica published a poll showing Solís with an overwhelming lead, the Associated Press reported. The poll had Solís leading with 64 percent support as compared to Araya's 21 percent. The telephone survey of 1,200 likely voters was conducted from Feb. 3-13 and has a margin of error of three percentage points. Araya, who served 22 years as mayor of San José before stepping down last year, decided to drop out because he did not want to spend any more money campaigning. "The runoff election is looking very difficult and filled with obstacles and our time and resources are limited," said Araya. Though he is ending his campaign, Araya's name will remain on the ballot, and the runoff will still be held because Costa Rica's constitution does not allow candidates to drop out at this stage. Solís, of the leftist Citizens' Action Party, urged Costa Ricans to vote and not assume that he has already won. "Without that vote put in the ballot boxes, without that vote counted … I won't be the president-elect," said Solís, a social science professor and historian. After Araya's announcement, Solís canceled a planned trip to Washington where he had been scheduled to speak at the Inter-American Dialogue. Solís said he will continue campaigning in Costa Rica ahead of the vote, but will try to do so without spending a large amount of money. "We have the confidence and ability to lead the country down the path of progress," he said.

Solís

File Photo: Solís campaign.

Nicaraguan President Emerges After 10-Day Absence

Nicaraguan President Daniel Ortega reappeared Monday after not being seen in public for 10 days, BBC News reported. Ortega's absence had led to rumors about his health. Ortega was seen Monday greeting new Nicaraguan Cardinal Leopoldo Brenes at Managua's airport. The president told Brenes that he had "carried out the miracle of resurrecting me because a lot of people thought I was dead." Ortega disappeared from official ceremonies after Feb. 21, leading to concerns about his health. He failed to show up for a Feb. 26 ceremony to commemorate a 1978 uprising in which his brother was killed. The next day, Ecuador's president canceled a planned visit to Nicaragua, citing scheduling conflicts on the part of Nicaragua's government. Some rumors circulated that Ortega had been receiving medical treatment in Cuba and some even speculated that he had died. Ortega, 68, is currently serving his third term as president. He was president from 1985 to 1990 after leading the revolution that overthrew the Somoza family's dictatorship. He returned to the presidency in 2007 and was re-elected in 2011. He is expected to seek re-election in 2016 after lawmakers approved a measure to do away with presidential term limits.

Before Monday, Ortega had not been seen in public since Feb. 21.

Economic News

Bachelet's Tax Plan Could Affect Investment: Finance Minister

Chilean President-elect Michelle Bachelet's tax reform plan could affect investment and may need to be watered down, the country's outgoing finance minister said Tuesday, Reuters reported. "The economy is decelerating, and I imagine the incoming government will take into account the economic situation and will try, I hope, to achieve a pretty wide consensus on tax reform," said Felipe Larraín. "If you put forward that kind of plan and tell me that won't affect investment, I don't know where that would be true." Bachelet takes office March 11 and has proposed reforms such as an increase of the corporate tax rate to 25 percent from 20 percent.

POLITICAL & ECONOMIC BRIEFS

Venezuela's Maduro Breaks Off Diplomatic Ties With Panama

Venezuelan President Nicolás Maduro announced Wednesday that the country was breaking diplomatic ties with Panama after it requested an urgent meeting of the Organization of American States to discuss the violent anti-government protests in Venezuela, the Associated Press reported. Maduro made the announcement at an event to mark the one-year anniversary of the death of his predecessor, Hugo Chávez. Maduro also said he was freezing trade and economic relations with Panama. In an official statement, Panama's government said it was "astonished."

Mexican Authorities Raid 11 Iron Ore Yards in Pacific Seaport

Mexican police, soldiers and inspectors on Monday raided 11 iron ore yards at the Lázaro Cárdenas port in Michoacán state and seized 120,000 tons of ore and 124 pieces of heavy machinery, the Associated Press reported. The state's federal security commissioner said the ore is being tested to see where it came from and if it is legal. Authorities have said that the Knights Templar drug cartel has mined and stolen ore for years.

Growth of Chile's Economic Activity Slows to Four-Year Low

Economic activity in Chile grew at its slowest pace in almost four years in January, Reuters reported Wednesday. The Imacec economic activity index rose 1.4 percent from December, its lowest rate since March 2010, according to the central bank. The weaker-than-expected figure comes after other reports of slower retail sales growth and higher unemployment, suggesting that the country's economy has slowed down more than expected.

Featured Q&A

Continued from page 3

addition of reserves. Since 2000, Ecopetrol, with the only exception being 2009, has shown a decline of 5.9 percent in the useful life of its oil reserves. No wonder Ecopetrol's shares have fallen by 42 percent in New York over the past year and have come under renewed pressure. Bancolombia has said that,"Since 2012, the market has begun to question the sustainability of Ecopetrol due to the poor growth in its reserves."

A **Daniel E. Velandia O., head of research and chief economist for Colombia at Credicorp Capital:** "The reduction of Ecopetrol's market capitalization since the first half of last year has been explained by both market factors and company-related issues. In general, Ecopetrol represents 20 percent of the main local stock index, being the natural vehicle for foreign investors to have exposure to the Colombian market. Hence, it is 'normal' to observe outflows from Ecopetrol's stock amid scenarios of higher risk aversion to emerging markets as has been the case since May 2013. On the other hand, financial results came in below expectations as net income fell 11.3 percent in 2013. Throughout last year, the financials were affected mainly by the increase of effective taxes after 2012's tax reform, a pension provision and goodwill impairments in the downstream subsidiaries. We consider these factors to be non-recurring events so that we would expect margins to stabilize in the upcoming quarters. At the same time, reserves addition, which continues to be the main concern for the long term, surprised the market on the positive side as reserves (1P) increased 5.1 percent year-on-year, while the replacement ratio was 139 percent, maintaining the reserves/production ratio unchanged at 8.1 years. Accordingly, we expect 2014 to be a better year for Ecopetrol in terms of both financial and stock performance. In fact, we believe the steep stock price decline over the last 12 months has taken the share to trade at levels more consistent with its fundamentals, and there is room for upside. Going forward, we will be focusing on the company's exploratory success and its ability to reach the ambitious production targets for 2015 (1 millions barrels of oil equivalent) and 2020 (1.3 Mboe). The management seems confident the company will meet the 2015 goal from four fields: Castilla, Chichimene, Akacías and Caño Sur."

A **Enrique Gómez-Pinzón, executive partner at Holland & Knight Colombia:** "It is certainly true that Ecopetrol's market capitalization fell significantly during calendar year 2013. Petrobras' market capitalization fell significantly during 2013 as well. In both circumstances, the stock value fell at the same time that Brazil's and Colombia's currency lost ground against the U.S. dollar. According to data from Feb. 6, Ecopetrol's market capitalization was $72 billion, while Petrobras' market capitalization was $74 billion. In 2013, three main events took place that strongly hit Ecopetrol's profit-and-loss statement: (i) Colombian tax reform. The new tax (CREE) hit Ecopetrol hard, (ii) the loss in value of Ecopetrol's public securities portfolio (TES), which in turn triggered the need to set up large reserves to fund the pension liabilities, and (iii) the creation of Cenit, a subsidiary owned 100 percent by Ecopetrol, which is paid market rates for crude transportation. In 2013, there was a significant increase in the transport expense line in Ecopetrol's profit-and -loss statement which will be compensated in 2014 by profits from Cenit. On the positive side, during 2013 Ecopetrol's proven (1P) reserves grew more than 5 percent and the replacement index for reserves grew more than 130 percent."

The Energy Advisor *welcomes responses to this Q&A. Readers can write editor Gene Kuleta at gkuleta@thedialogue.org with comments.*

Latin America Energy Advisor
is published weekly by the Inter-American Dialogue

Erik Brand
Publisher
ebrand@thedialogue.org

Gene Kuleta
Editor
gkuleta@thedialogue.org

Megan Cook
Reporter, Assistant Editor
mcook@thedialogue.org

Subscription Inquiries are welcomed at
freetrial@thedialogue.org

Latin America Energy Advisor is published weekly, with the exception of some major US holidays, by the Inter-American Dialogue
1211 Connecticut Avenue NW, Suite 510
Washington, DC 20036
Phone: 202-822-9002 Fax: 202-822-9553
www.thedialogue.org ISSN 2163-7962

