

Eye on Ecopetrol

Assessing Ecopetrol Performance

In the global oil and gas industry, when an International Oil Company (IOC) sets its production targets for the future, market analysts would understand them as equity production, that is, the sum of the production that such IOC is entitled to take in accordance with the 'working interests' it holds in the valid petroleum contracts it has been awarded worldwide.

This is not the case with Ecopetrol (ECO), though. ECO has set its Mega-target for 2015 as: "to produce one-million clean barrels of oil equivalent per day (mmbob/d)". By 1 mmbob/d, ECO here means gross production which includes royalties.

There are at least two plausible reasons that may explain why production targets should be understood as equity rather than gross ones. The first is that under the US Securities and Exchange Commission (SEC) rules IOCs are not allowed to book royalty barrels (Note: Canadian rules are different in this regard). The second reason is more practical: IOCs would not expect analysts to find out for themselves the prevailing fiscal regimes in all the countries they

conduct operations, in particular the applicable royalties' regimes for each country.

Although ECO operates in just four countries (Colombia, Brazil, United States, Peru), Colombia production still represents the lion's share. But even in this case, the issue is not straightforward. In fact, just in Colombia, ECO participates in more than 250 fields, with royalties' rates that vary from as low as 0% (i.e. Velásquez private concession) to rates as high as 32% (i.e. Tello reverted public concession). (Note: We contacted some analysts for this article and they agreed with our conclusion: the distinction is not made clear in ECO's presentations.)

Based on our proprietary database, we have attempted to translate such gross figures into equity ones: the result is that on average for the oil and gas fields where ECO participates the equity production share of the gross is around 84%, which is to say that on average the level of royalties is about 16%. Thus, if this rate were to be unmodified to 2015, the 1mmbob/d target would actually mean 840kboe/d equity production.

However, assuming that the royalty level will hold unaltered is not just a risky bet but also an indirect measure of ECO performance: our focus is how much production ECO can bring into its books, not about how good they are at handling and marketing royalties they do not own.

Therefore, in future issues we will always keep an eye on their equity production or as it is called by the financial analysts their 'underlying asset', which is the ultimate physical measure that really adds value to an oil and gas company.

Bottom-Line: Ecopetrol is not the first oil and gas company to make numbers look better by being unclear about definitions and it will not be the last. Investors should insist that words like "production" be clearly defined so apples can be compared to apples and oranges to oranges. This is not an academic exercise. Many performance measures depend on having the right measure of output.

Ecopetrol Group
Gross versus Equity Production - kboe/d

