RATING ACTION COMMENTARY

Fitch Affirms SierraCol's IDR at 'B+'; Outlook Stable

Thu 25 May, 2023 - 12:54 p. m. ET

Fitch Ratings - New York/Bogota - 25 May 2023: Fitch Ratings has affirmed SierraCol Energy Limited's Long-Term Foreign and Local Currency Issuer Default Rating (IDR) at 'B+'. The Rating Outlook is Stable. In addition, Fitch has affirmed SierraCol Energy Andina, LLC's Long-Term senior unsecured ratings at 'B+'/'RR4'.

SierraCol's ratings reflect its small but stable low-cost production profile of roughly 44,300 boed in 2022, which is balanced across its two main asset, Cano Limon and La Cira Infantas. SierraCol has a long track record operation in Colombia with solid production expected to average a net 44,000 boed through the rating horizon, and 1P reserve life to average 8.0 years. The company has a strong leverage profile, which Fitch expects to remain at or below 2.0x through the rating horizon.

Despite strong operating metrics, the ratings remain constrained by the company's relatively small size and the low diversification of its oil fields.

KEY RATING DRIVERS

Small Concentrated Production Profile: SierraCol's ratings are constrained by its production size, projected to average 44,000 boed over the next four years, relative to the rating trigger of 75,000 boed. The company has a concentrated production profile split between its mains assets (CLM and LCI), representing 90% of total production, which it operates as a joint venture with Ecopetrol (BB+/Stable).

SierraCol produces high-quality crude with 94% of production having API between 25-35, which gives it preferential treatment to sell locally to Ecopetrol, under contracts that guarantee pricing at a premium to the vasconia discount.

Efficient Cost Producer: SierraCol is one of the lowest-cost producers in Latin

Efficient Cost Producer: SierraCol is one of the lowest-cost producers in Latin America. Its half-cycle costs were estimated to be $22/boe in 2022and full-cycle cost of $34/boe in 2022, according to Fitch's calculation, which is the half-cycle cost plus the three-year average FD&A for 1P of $10/boe and plus a 15% of return on capital invested ($2/boe). SierraCol's realized oil price is higher than peers due to the quality of its crude and its low transportation cost of $1/boe as per its legacy contract with Ecopetrol, which compares favorably to most of the peers in the Region. SierraCol's realized average price was $92/bbl in 2022, a discount to Brent of $7/bbl.

Strong Leverage Profile: Fitch projects SierraCol's total debt to EBITDA ratio will be at or below 2.0x over the rating horizon. Fitch does not assume material addition or decreases in debt through the rating horizon. Fitch expects the company's debt to PDP of $11/boe and total debt to 1P of $7/boe in 2023, and then decline to $10/boe and $6/boe in 2025, respectively.

The latter assumes an average reserves replacement ratio (RRR) of 105% for both PDP and 1P and average reserve life of five years and eight years, respectively, as the company deploys its 2023-2027 capex plan with aggregate amount close to USD865 million.

Financial Flexibility: SierraCol is fully financed and should be able to cover all capex projects with internal cash flows. Under Fitch's price deck and production assumptions, Cash Flow from Operations (CFO) should cover capex by more than 1x over the next four years. As of march 2023, the company's liquidity was adequate with cash and cash equivalents of USD115 million plus USD83 million in undrawn amounts from committed credit lines. The company's major debt maturity is its USD600 million bond which matures in June 2028.

The rating case is assuming dividends will be paid each year to its controlling shareholder, The Carlyle Group; however, Fitch does not expect dividends to materially exceed FCF.

DERIVATION SUMMARY

SierraCol Energy's credit and business profile is comparable to other small independent oil producers in Colombia. Geopark (B+/Stable), Frontera Energy Corporation (B/Stable), and Gran Tierra Energy International Holdings Ltd. (B/Stable) are all constrained to the 'B' category or below, given the inherent operational risk associated with small scale and low diversification of their oil and gas production.

SierraCol's production profile compares favorably with other 'B' rated oil exploration and production companies operating in Colombia. Over the rated horizon, Fitch expects SierraCol's gross production will average 44,000 boed, slightly lower than Geopark's 48,000 boed, and in line with that of Gran Tierra Energy at 40,000 boed and Frontera's 42,000 boed. SierraCol's PDP reserve life of 4.5 years and 1P reserve life of 7.1 years in 2022 are above the peer average of 3.6 years and 7.0 years life of 7.1 years in 2022 are above the peer average of 6.0 years and 7.0 years, respectively.

Fitch estimates SierraCol's half-cycle cost, which does not take into consideration delivery points, was $22/boe in 2022 and full-cycle cost was $34/boe in line with Geopark, who is the lowest cost producer in the region at $14 bbl and $39 bbl and below Gran Tierra at $22/boe and $34/boe, and Frontera at $29/boe and $59/boe.

SierraCol's has strong capital structure expected to have a gross leverage that will be at or below 2.0x over the rated horizon and debt to PDP of $11/boe and total debt to 1P of $7/boe, which is lower than most peers in LatAm.

KEY ASSUMPTIONS

Fitch Ratings Makes the Following Key Assumptions in the Ratings Case for the Issuer:

--Fitch's price deck for Brent of $85 for 2023, $75 for 2024, $65 for 2025 and $53 thereafter;

--Average daily gross production of 44,000 boed from 2023 through 2026;

--Reserve replacement ratio of 105% per annum per rated horizon;

--Lifting and transportation cost average of $16boe over rated horizon;

--SG&A cost average of $3.25boe over rated horizon;

--Hedging cost average of $0.5boe over rated horizon;

--Consolidated capex of $696 million from 2023 through 2026 averaging $174 million per year;

--Minimum cash balance assumed at $120 million over rated horizon;

--Effective tax rate of 40% over rated horizon.

RATING SENSITIVITIES

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

--Net production rising consistently to 75,000 boed on a sustained basis while maintaining a total debt to 1P reserves of USD5.00 barrel or below;

--Reserve life is unaffected as a result of production increases, at approximately seven to eight years to eight years.

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

--Extraordinary dividend payments that exceed FCF and weaken liquidity;

--Sustainable net production falls below 30,000 boed;

--Reserve life declines to below 6.0 years on a sustained basis;

--A significant deterioration of total debt/EBITDA to 3.0x or more.

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

Adequate Liquidity: SierraCol's cash and cash equivalents balance as of March 2023 was $115 million, plus USD83 million in undrawn amounts of committed credit lines. Total available liquidity cover interest expense of the next four years by 1.3x. Furthermore, the company is fully financed and Fitch projects that capex will be funded with internal cash flows with no material increases nor reductions in total debt. SierraCol has a favorable debt maturity profile, where its USD600 million matures in June 2028.

ISSUER PROFILE

SierraCol Energy Limited (SierraCol) is an independent oil producer in Colombia that was created after Carlyle acquired Occidental Petroleum Corporation's operations in Colombia in December 2020. SierraCol is the third largest oil producer in Colombia with assets in Llanos, Middle Magdalena, and Putumayo basins in Colombia. Its key assets are Caño Limon (CLM) and La Cira Infantas (LCI), two of Colombia's most prolific and long-lived fields, which it operates in partnership with Ecopetrol. SierraCol's average daily production is 44,300bbl/d with a 1P reserve life of 7.1 years and total debt to EBITDA of 0.7x and Total Debt to 1P of $7.03bbl.

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.

ESG CONSIDERATIONS

SierraCol's ESG Relevance Score for GHG Emissions & Air Quality is '4' due to the growing importance of the continued development and execution of the company's energy-transition strategy. This 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			RECOVERY	PRIOR
SierraCol Energy Limited	LT IDR	B+	Affirmed		B+
	LC LT IDR	B+	Affirmed		B+
SierraCol Energy					

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VIEW ADDITIONAL RATING DETAILS

Additional information is available on www.fitchratings.com

PARTICIPATION STATUS

The rated entity (and/or its agents) or, in the case of structured finance, one or more of the transaction parties participated in the rating process except that the following issuer(s), if any, did not participate in the rating process, or provide additional information, beyond the issuer's available public disclosure.

APPLICABLE CRITERIA

Corporates Recovery Ratings and Instrument Ratings Criteria (pub. 09 Apr 2021) (including rating assumption sensitivity)

Corporate Rating Criteria (pub. 28 Oct 2022) (including rating assumption sensitivity)

Country-Specific Treatment of Recovery Ratings Criteria (pub. 03 Mar 2023)

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

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

SierraCol Energy Andina, LLC	EU Endorsed, UK Endorsed
SierraCol Energy Limited	EU Endorsed, UK Endorsed

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Energy and Natural Resources | Corporate Finance | Latin America | Colombia

ENTITIES

SierraCol Energy Andina, LLC

SierraCol Energy Limited

ISSUER CONTENT

Latin American Oil & Gas Netback — Peer Review

SierraCol Energy Limited

Fitch Affirms SierraCol's IDR at 'B+' and Unsecured Notes at 'B+'/'RR4'; Outlook Stable

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

Fitch Ratings 2022 Outlook: Latin American Energy (Oil & Gas)

Latam Oil & Gas Full-Cycle Costs Below Brent and WTI

Latin American Oil & Gas Netback - Peer Review

SierraCol Energy Limited

Fitch Assigns 'B+' First Time Rating to SierraCol Energy Limited; Outlook Stable

RECOMMENDED CONTENT

Carrier Global Corporation

Archer Daniels Midland Company

Rey Holdings Corp. y Subsidiarias e Inmobiliaria Don Antonio, S.A. y Subsidiarias

Fitch Affirms Ericsson at 'BBB-'; Outlook Stable

Fitch Ratifica Clasificación de Chilquinta Distribución en 'AA(cl)'

Fitch Afirma Calificación de la Industria Licorera de Caldas en 'AA-(col)'; Perspectiva Estable

Fitch Asigna 'AA(mex)' a Emisiones Propuestas de Certificados Bursátiles de Betterware

Fitch Affirms Carlsberg Breweries at 'BBB+'; Outlook Stable

European LNG Imports on the Rise

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RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		

EVOLVING		
STABLE		

RECOVERY RATINGS KEY

OUTSTANDING	SUPERIOR	GOOD	AVERAGE	BELOW-AVERAGE	POOR
RR1	RR2	RR3	RR4	RR5	RR6

* Ratings displayed in orange denotes EU or UK Unsolicited and Non-Participatory Ratings

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

*Premium content is displayed in Fitch Red