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Research Update:

Pacific Rubiales Energy Corp. Upgraded To 'BB' From 'BB-' On Improved Financial Profile

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Table Of Contents

Overview

Rating Action

Rationale

Outlook

Related Criteria And Research

Ratings List

Research Update:

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Overview

- Pacific Rubiales operating and financial performance has exceeded our expectations.
- We are raising our corporate credit rating on the company to 'BB' from 'BB-'.
- The stable outlook reflects our view that Pacific Rubiales will continue to post a strong financial performance and that the company's good positioning will allow it to continue executing its growth strategies.

Rating Action

On July 5, 2011, Standard & Poor's Ratings Services raised its corporate credit rating on Pacific Rubiales Energy Corp. to 'BB' from 'BB-'. We also raised our rating on Pacific Rubiales' \$450 million senior unsecured notes due 2016 to 'BB'. The outlook is stable.

Rationale

The upgrade is based on the company's continued improvement in its operating and financial performance, which has exceeded our expectations. For the past 12 months (LTM) ended March 31, 2011, the company's revenues doubled, reaching \$1.9 billion, mainly as a result of the increase in production at the Rubiales' and Quifa's heavy oil fields and, to a lesser extent, the start of operations in Peru and Guatemala. Moreover, the company's profits continue to improve, reaching an adjusted EBITDA margin of 56.8% as of March 31, 2011 (compared with 50.3% of the same period of 2010).

For the past 12 months ended March 31, 2011, Pacific Rubiales posted an adjusted debt-to-EBITDA, funds from operations (FFO)-to-debt, and EBITDA interest coverage ratios of 0.8x, 89.4%, and 12.0x, respectively, which compares favorably with 1.8x, 39.3%, and 7.9x of the same period of 2010. For the past 12 months ended March 31, 2011, the company's adjusted discretionary cash flow was \$157.2 million.

The ratings on Pacific Rubiales also reflect our view of a fair business profile given the company's short track record and heavy concentration in the Colombian region. Pacific Rubiales is still a small exploration and production (E&P) company, although growing, when compared with other regional and local players. Recent and expected strong growth in production and reserves, strong liquidity, an experienced management team, and significant financial profile support the rating.

Pacific Rubiales, which began operations in 2007, is Colombia's second-largest operator and produces heavy crude oil and natural gas. As of March 31, 2011, it had a gross production of approximately 225,000 barrels of oil equivalent per day, with working interests in 40 blocks: 35 in Colombia, two in Guatemala, and three in Peru. Pacific Rubiales' exploration and investment programs continue increasing the company's production volume, which, coupled with higher oil prices, have led to a strong financial performance. During first-quarter 2011, Pacific Rubiales' gross production increased 38% compared with the fourth quarter of 2010. The company has significantly increased its production volume based on the continuous growth in the production of heavy oil in its fields. Pacific Rubiales' production is concentrated on the Rubiales/Piriri, Quifa, and La Creciente fields, which produce heavy oil, requiring the company to incur additional costs by purchasing diluents in the market. However, the company is working on its Llanomulsion project, which could eliminate the need for diluents and therefore could have significantly help the transportation costs for the Rubiales and Quifa fields.

Mainly because of increasing volumes and higher oil prices, Pacific Rubiales' credit metrics have improved beyond our expectations. Our adjusted debt includes asset retirement obligations, operating leases, the ship or pay obligation of the company to guarantee full payment on the Oleoducto de los Llanos (ODL) loan, and the proportion of convertible unsecured subordinated debentures classified as equity. The company's four-year strategic plan includes investments of about \$4 billion in development drilling, exploration, and production facilities, among others. We expect the company to fund these expenditures with internally generated funds. In 2011 and 2012, considering our price deck of \$75-\$80 per barrel and \$75 per barrel, respectively, we expect the company to generate adjusted FFO to debt of 122% and 154%, respectively. We expect its debt-to-EBITDA ratio to be about 0.5x in the next two years.

Liquidity

Pacific Rubiales' liquidity is strong, and we believe the company's resources can more than cover its needs for the foreseeable future, even assuming sharp declines in EBITDA. We expect Pacific Rubiales' liquidity resources (including cash, FFO, and credit facility availability) to exceed uses by 1.5x or more over the next 12 to 18 months. As of March 31, 2011, the company had a cash position of \$610.6 million, which compares favorably with debt maturities of \$5.9 million for the next 12 months. In addition, in April 2011, the company increased its committed credit line availability to \$350 million from \$250 million. The company's next major maturity is due in 2013 (\$228.2 million). Despite its high capital expenditures, the company generated unadjusted free operating cash flow before we expected it to (\$147.5 million as of March 31, 2011). We believe the company will continue generating discretionary free operating cash flow in 2011 and 2012 of \$4.7 million and \$363 million, respectively, despite its expansion program and its dividends distribution.

Pacific Rubiales' covenants headroom was ample as of March 31, 2011. In 2011

and 2012 we expect the company to maintain about an 85% EBITDA cushion against the unadjusted consolidated leverage ratio covenant of 3.5x and the unadjusted interest coverage ratio covenant of 3.0x.

Outlook

The stable outlook reflects our view that the company's financial performance will continue to be strong and that its good position will allow the company to continue executing its organic and geographic diversification growth strategies.

If the company's production growth is beyond our expectations in the next few years and improves its geographic diversification while maintaining its current financial profile, we could raise the ratings. We could lower the ratings if the company's liquidity or financial flexibility deteriorates significantly to an adjusted total debt-to-EBITDA ratio of more than 3.0x and adjusted FFO to total debt of less than 20%.

Related Criteria And Research

- Methodology And Assumptions: Standard & Poor's Standardizes Liquidity Descriptors For Global Corporate Issuers, July 2, 2010
- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, May 27, 2009
- Key Credit Factors: Business And Financial Risks In The Oil And Gas Exploration And Production Industry, Nov. 10, 2008
- 2008 Corporate Criteria: Analytical Methodology, April 15, 2008

Ratings List

Upgraded

	To	From
Pacific Rubiales Energy Corp.		
Corporate Credit Rating	BB/Stable/--	BB-/Stable/--
Senior Unsecured	BB	BB-

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