

Research Update:

# **DRAFT: Avianca Downgraded To 'CCC' And On Watch Negative On Tightening Liquidity; LifeMiles Downgraded To 'B-', Outlook Stable**

March 20, 2020

## Rating Action Rationale

- The global spread of the coronavirus has significantly reduced demand for air travel in recent weeks. As a result, we expect Avianca Holdings S.A.'s (Avianca) operating results to materially deviate from our prior assumptions.
- The company has taken immediate measures to manage the impact of reduced demand for global air transport. However, we believe that these measures will be insufficient to offset the impact on the company's credit metrics, tightening its already stressed liquidity. Thus, we believe Avianca faces higher refinancing risk.
- On March 20, 2020, S&P Global Ratings lowered its issuer credit rating on Colombia-based airline operator Avianca to 'CCC' from 'B-'. We are also lowered our rating on its senior secured notes to 'CCC' from 'B-' and on its senior unsecured to 'CCC-' from 'CCC+'.
- At the same time, we lowered our issuer credit rating on LifeMiles LTD and our issue-level rating on the company's senior secured term loan to 'B-' from 'B+'. The outlook is stable.
- We placed our ratings on Avianca on CreditWatch with negative implications, reflecting that a prolonged travel disruption could further deteriorate the company's liquidity.

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## Rating Action Rationale

**Reduced travel demand and capacity will affect Avianca's credits metrics.** The Colombian government recently announced that it will close the Colombian international airspace to passenger travel effective March 23, 2020. Therefore, Avianca will cease international passenger capacity for the next 30 days (which represented 50% of the company's revenues as of Dec. 31, 2019), and will reduce domestic capacity by 84%. Although the company has immediately implemented additional cost savings, we do not believe these measures will be adequate to offset the impact of already deteriorated liquidity and credit metrics. As a result, we downgraded the company. We now expect the company's debt to EBITDA to remain well above 5x, funds from

operations (FFO) to debt below 6%, and pressured EBITDA margins below 15%.

**Company's liquidity will further weaken.** We expect the company's liquidity to further deteriorate, with a ratio of 0.69x of expected cash sources to its uses. Our liquidity assessment also reflects Avianca's likely inability to absorb low-probability adversities. Its short-term debt maturities consist of \$65.6 million due in May 2020, corresponding to 11.92% of the notes that Avianca did not exchange; \$237 million of aircraft leases; and \$569 million related to financial debt due in the next twelve months. Although we believe that the company has sufficient cash on hand (\$540 million as of Feb. 20, 2020) to cover its May maturity, there is a high risk that it won't be able to cover the remaining obligations in light of the impact of COVID-19. Finally, Avianca was not in compliance with its incurrence financial covenants as of Dec. 31, 2019. As a result of these factors, we now envision a default scenario occurring in the next 12 months.

**Operating results to materially weaken from our prior assumptions.** In our previous base case, we were expecting that Avianca's financial and operating performance would likely recover as a result of a recent reorganization. However, we now expect a material capacity reduction together with an available seat kilometers (ASK) decline that will affect the company's top line results from an already weak 2019.

**Avianca's credit quality influences that of LifeMiles.** Avianca owns 70% of LifeMiles, and Advent International (not rated) owns the remaining 30%. The downgrade of LifeMiles reflects that of its parent company, Avianca, but we limit it to 'B-' given that LifeMiles is an insulated subsidiary with a separate governance structure, and we don't expect Avianca would intervene in LifeMiles' operations. As a result, the outlook is stable, and the rating on LifeMiles wouldn't be affected if we take a further rating action on its parent.

## Liquidity

We continue to assess Avianca's liquidity as weak, given that we expect the company's sources of liquidity to be sharply lower than its uses in the next 12 months--well below 1.0x--reflecting a wide deficit.

### Principal liquidity sources:

- Cash and short-term investments of about \$540 million as of Feb. 20, 2020; and
- FFO of about \$742 million for the next 12 months.

### Principal liquidity uses:

- Short-term debt maturities of \$872 million for the next twelve months;
- Maintenance and committed capital expenditures of about \$361 million for the next 12 months;
- Working capital outflows for about \$533 million in the next 12 months; and
- Dividend payments of \$74.8 million in the next 12 months.

## CreditWatch

We expect to resolve the CreditWatch placement once we have more visibility about the impact that the coronavirus will have on Avianca's liquidity position.

## Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Transportation Cyclical Industry, Feb. 12, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | Industrials: Key Credit Factors For The Business And Consumer Services Industry, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings, Oct. 1, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

## Ratings List

### Downgraded

|                      | To           | From         |
|----------------------|--------------|--------------|
| <b>LifeMiles LTD</b> |              |              |
| Issuer Credit Rating | B-/Stable/-- | B+/Stable/-- |
| Senior Secured       | B-           | B+           |

### Downgraded; CreditWatch/Outlook Action

|                              | To               | From         |
|------------------------------|------------------|--------------|
| <b>Avianca Holdings S.A.</b> |                  |              |
| Issuer Credit Rating         | CCC/Watch Neg/-- | B-/Stable/-- |
| Senior Secured               | CCC/Watch Neg    | B-           |
| Senior Unsecured             | CCC-/Watch Neg   | CCC+         |

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