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Research Update:

Avianca Rating Cut To 'SD' On Missed Principal Payments, 'CCC' Debt Ratings Still On Watch; LifeMiles Downgraded To 'B-'

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Research Update:

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Rating Action Overview

- On July 22, 2019, Colombia-based airline operator Avianca Holdings S.A. announced that it has missed payments on several long-term leases and on the principal on some loan obligations, which constitutes an event of default.
- The company also announced an exchange offer proposal on its \$550 million senior unsecured notes due May 2020 that, in our view, will not constitute a distressed exchange because the offer considers a par-value exchange with a higher interest rate and collateral promising equal or more value than the original notes, despite an extended maturity.
- On July 23, 2019, S&P Global Ratings lowered its issuer credit rating on Avianca to 'SD' from 'CCC+' and kept the 'CCC' issue-level ratings on CreditWatch with negative implications. Additionally, we lowered our issuer credit and issue-level ratings on LifeMiles LTD to 'B-' from 'B'.
- The issue-level rating on Avianca remains on CreditWatch negative, reflecting a potential downgrade if Avianca does not complete its exchange offer. We expect to resolve the CreditWatch within the next 90 days.
- The stable outlook on LifeMiles reflects our view that it will maintain a solid operating and financial performance in the next 12 months. We also don't believe that Avianca would have any potential extraordinary intervention in LifeMiles.

Rating Action Rationale

The downgrade follows Avianca's announcement that it missed the payments on several long-term leases and on the principal on some loan obligations, which constitutes an event of default. Moreover, the company announced an exchange offer proposal on its existing \$550 million 8.375% senior unsecured notes due May 2020. According to the terms of the senior unsecured notes, Avianca hasn't yet fallen into an event of default because the total amount of the principal on the loan obligations, which have been deferred, hasn't yet reached \$50 million. However, we believe Avianca could reach this threshold if the company doesn't reach an agreement with its creditors. Avianca has offered to exchange the notes at par value with a higher coupon rate (9%) and maturing in May 2023 with additional collateral. The collateral consists of certain intellectual property, including the "Avianca" brand and stock representing the residual

value after debt and other liabilities of the company's aircraft fleet estimated at about \$1 billion, which we believe could compensate creditors. We believe that the full terms of the exchange offer are equal or more to the promise of the original notes and that the transaction is not a distressed exchange even though the notes mature in less than 12 months.

We believe Avianca will maintain operations with no significant changes, preventing a negative impact on its current clients, suppliers, and internal workforce. Since May 24, 2019, Kingsland Holdings (Avianca's minority shareholder) has effective control of Avianca. In addition, United Airlines Inc. and Kingsland have indicated that they would be willing to offer new financing to Avianca of up to \$250 million before the conversion to the new notes. However, we believe that other parties such as strategic creditors must make commitments to maintain Avianca's capital structure, and the company has mentioned it intends to resume scheduled principal payments once it has reached an agreement with them. Moreover, Avianca recently appointed new management tasked with improving the company's operations and profitability, as well as its capital structure.

The negative CreditWatch listing reflects a potential downgrade if Avianca does not complete the exchange proposal. Failure to execute the exchange offer within 90 days could trigger a downgrade.

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 and our expectation that Avianca wouldn't intervene in LifeMiles' operations.

CreditWatch and Outlook

We intend to resolve the negative CreditWatch listing on Avianca's issue-level rating within the next 90 days. Failure to execute the exchange offer within 90 days could trigger a downgrade.

The stable outlook on LifeMiles reflects our view that it will maintain a solid operating and financial performance in the next 12 months, maintaining its solid EBITDA through cost efficiencies and financial planning. These factors will allow

LifeMiles to preserve its current key credit metrics and liquidity position. We believe LifeMiles would not have any potential extraordinary intervention from Avianca.

A higher rating on Lifemiles would require a similar rating action on Avianca to at least 'CCC+', given the company's maximum two-notch rating differential above that of its parent.

Company Description

Avianca, through its subsidiaries, engages in the passenger and cargo air transportation services, aircraft maintenance, airport services to other carriers, travel-related services to its customers, and ground operations for third-party airlines in hub airports. Moreover, Avianca is the main shareholder of LifeMiles, a loyalty rewards program company. Avianca is Colombia's largest airline. It has operations in 27 countries and flies to 105 destinations in the U.S., Latin America, and Europe. Avianca was founded in 1919 and is headquartered in Panama City, Panama.

Issue Ratings - Subordination Risk Analysis

Capital structure

As of March 31, 2019, Avianca's capital structure primarily consisted of \$3.3 billion in financial leases related to aircraft purchases, \$1.1 billion in corporate debt, which consists of about \$400 million of unsecured revolving credit lines, LifeMiles' term loan of about \$426 million, and about \$200 million in other bank loans. The remaining amount consists of the rated senior unsecured notes due 2020 with an outstanding amount of \$568 million and the \$28.5 million senior secured local bonds.

LifeMiles' capital structure consists of the first-lien senior secured term facility for an original amount of \$300 million due 2022 and the incremental facilities of \$95 million in March 2018 and \$100 million in January 2019. As of March 31, 2019, the outstanding amount of the term facility due 2022 was \$426 million.

Analytical conclusions

We rate Avianca's senior unsecured notes at 'CCC', given that the notes are currently vulnerable to nonpayment and their structural subordination to the existing secured debt. Under our criteria, aircraft financings are assumed to be senior secured obligations with priority of payment relative to unsecured debt. We exclude operating leases from the calculation. Currently, Avianca's debt priority ratio is about 85% of total debt.

We rate the first lien senior secured term facility at 'B-', the same level as the issuer credit rating on LifeMiles, because the company and its direct and indirect subsidiaries will unconditionally guarantee the debt instrument on a senior secured basis. The security package consists of a first priority interest in all tangible and intangible assets (including capital stock of subsidiaries) of the respective borrower and guarantors.

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
- Criteria | Corporates | Industrials: Key Credit Factors For The Business And Consumer Services Industry, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Timeliness Of Payments: Grace Periods, Guarantees, And Use Of 'D' And 'SD' Ratings, Oct. 24, 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
- General Criteria: Rating Implications Of Exchange Offers And Similar Restructurings, Update, May 12, 2009

Ratings List

Downgraded; CreditWatch/Outlook Action

	To	From
Avianca Holdings S.A. Issuer Credit Rating	SD/--	CCC+/Watch Neg/--
LifeMiles LTD Issuer Credit Rating	B-/Stable/--	B/Watch Neg/--
Senior Secured	B-	B/Watch Neg

Ratings Affirmed

Avianca Holdings S.A. Senior Unsecured	CCC/Watch Neg
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