Research Update:

Avianca Holdings Upgraded To 'B-' From 'SD' And LifeMiles To 'B+' From 'B-' On Debt Restructuring Completion

December 20, 2019

Rating Action Overview

- Colombia-based airline operator Avianca Holdings S.A. announced the completion of its liability management plan after the renegotiation of its operating and financial leases.
- The company also announced the satisfaction of conditions for the exchange of Avianca's $484.4 million 8.375% senior secured notes due 2020 for the new 9% senior secured notes due 2023. This comes after the company received the expected $250 million from shareholders, Kingsland Holdings Limited (Kingsland) and United Airlines Inc. (United).
- On Dec. 20, 2019, S&P Global Ratings raised its issuer credit rating to 'B-' from 'SD' and its issue-level rating on the 9% senior secured notes due 2023 to 'B-' from 'CCC-' and the 8.375% senior unsecured notes due 2020 to 'CCC+' from 'CC' on Avianca.
- At the same time, we raised our issuer credit and issue-level ratings on LifeMiles LTD, a loyalty rewards program company, to 'B+' from 'B-'.
- The stable outlook on Avianca and LifeMiles reflects our view that they will maintain a solid operating and financial performance in the next 12 months. We also believe that Avianca's capital structure will be manageable after debt restructuring.

PRIMARY CREDIT ANALYST

Humberto Patino
Mexico City
+ 52 55 5081 4485
humberto.patino
@spglobal.com

SECONDARY CONTACT

Fabiola Ortiz
Mexico City
(52) 55-5081-4449
fabiola.ortiz
@spglobal.com

Rating Action Rationale

Avianca completes its liability management plan

The upgrade reflects our reassessment of Avianca's credit quality after the company announced the completion of its debt-restructuring plan. At this point, the company had exchanged 88.1% of its 8.375% senior unsecured notes due 2020 for the new 8.375% senior secured notes due 2020 (mandatory conversion by Dec. 31, 2019). At the same time, Avianca received $250 million from Kingsland and United under a convertible secured loan, which triggers the exchange of $484.4

million of principal amount of its existing 8.375% senior secured notes due 2020 for an equivalent principal amount of 9% senior secured notes due 2023, which will occur on Dec. 31, 2019. At the same time, the company completed all of its operating and financial lease renegotiations and extended its contract period, which will allow for a more manageable capital structure in the next 12 months.

Avianca's financial and operating performance likely to recover

The credit rating reflects Avianca's still weak credit metrics, including debt to EBITDA remaining above 5.0x and funds from operations (FFO) to debt of about 10%. Avianca's debt restructuring included the reorganization of all routes and frequencies and the slowing of its fleet renewal pace. We believe Avianca will focus on its most profitable routes by eliminating some of its regional flights and increasing its trans-border services through main hubs in Colombia, Costa Rica, El Salvador, and Peru. At the same time, we expect a more cautious capital expending for fleet renewals, which will alleviate pressure on Avianca's cash generation.

About 65% of the company's total operating costs are in dollars, primarily jet fuel, maintenance, airport fees, and some workforce expenses. In addition, Avianca's 81.2% revenues are denominated in, or linked to, the dollars, and approximately 6.9% in Colombian pesos, mainly stemming from international route tickets in greenback. However, domestic ticket prices are also exposed to FX volatility. We consider that the company holds a natural hedge on its exposure to the dollar-denominated expenses.

Liquidity to remain weak in the next 12 months

In addition, the weak liquidity will constrain the credit rating. For the next 12 months, we expect the company to maintain a ratio of 0.86x of expected cash sources to its uses. Our liquidity assessment also reflects Avianca's likely inability to absorb low-probability adversities. However, the company received an additional $125 million under secured financing commitments, which we expect to alleviate pressure on the company's funding, while it's implementing its new operating and financial strategy.

Avianca's credit quality influences that of LifeMiles

Avianca owns 70% of LifeMiles, and Advent International (not rated) owns the remaining 30%. The upgrade of LifeMiles reflects that of its parent company, Avianca, given that LifeMiles is an insulated subsidiary. This reflects LifeMiles' 'bb-' stand-alone credit quality, constrained by the parent company's credit quality.

LifeMiles generates only about 30% of gross billings from the sale of miles to its parent company under a 20-year exclusive agreement, while the remaining 70% come from long-term agreements with third parties and direct sales to members. Therefore, LifeMiles' financial performance and funding prospects are independent from those of Avianca, so that even if other core entities encounter severe setbacks, LifeMiles' relative strengths would remain mostly intact. We believe Avianca has a compelling economic incentive to preserve LifeMiles' credit strength because the subsidiary is an important source of passenger traffic for the airline.

Outlook

The stable outlook reflects our expectation that Avianca will gradually improve its operating and financial performance by focusing on its profitability and strengthening its cash flow generation, leading to EBITDA margins of about 20% by 2020. We expect the company to gradually deleverage in the next 12 months after the rescheduling and cancellation of new aircraft purchases in the upcoming years, reflected in debt to EBITDA slightly above 5.0x and FFO to debt of about 10% in the next 12-18 months.

Downside scenario

We could lower the ratings if adverse industry conditions cause the company's EBITDA margins to weaken, debt to EBITDA to rise to more than 7.0x, and FFO to debt to drop below 6% on a sustained basis. The industry slump would likely stem lower-than-expected economic growth, foreign exchange (FX) volatility, and prolonged spike in jet fuel prices, increased competition, and incurrence of additional debt.

Upside scenario

Although unlikely in the short to medium term, we could raise the ratings if the company's operating performance is above our expectations, which would result in debt to EBITDA of well below 5.0x and FFO to debt well above 12% on a sustained basis. That could result from stronger regional economic growth, faster consolidation of the company's new operating strategy, or a significant debt reduction. We could also upgrade the company if it strengthens its business profile by expanding its operations and strengthening its competitive position, which could result from strategic alliances or internal growth. Finally, an upgrade is also possible if the company increases its cash generation on a consistent basis, which would prompt us to revise our liquidity assessment to a stronger category.

Company Description

Avianca, through its subsidiaries, offers 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. 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.

Our Base-Case Scenario

- Colombia's GDP growth of 3.2% for 2019 and 3.2% for 2020, and inflation of 3.9% and 3.2%, respective years. We believe that these macroeconomic conditions will allow Avianca to increase the volume of passenger traffic and cargo/mail customers. For the nine months as of Sept. 30, 2019, Avianca's domestic service traffic increased 1.6% to 13.1 million passengers from 12.9 million passengers for the same period in 2018. Its international service traffic rose 2.8% to 10 million passengers from 9.7 million passengers in 2018.
- Average exchange rates of COP3,350 per $1 in 2019 and COP3,4OO per $1 in 2020. Year-end

exchange rates of COP3,275 per $1 and COP3,375 per $1 for respective years.

- Similarly to levels in 2018, the average ticket price for Avianca will reach $129 for 2019 and $131 for 2020, mainly because of our expectation of higher international traffic and its updated routes and frequencies.
- Revenue to slip 3.1% for 2019 due to lower ticket prices for the first nine months in order to remain competitive with peers. Revenue to grow 1.3% in 2020. In addition, the company is constantly evaluating its route offerings to maintain load factors above 80%. Load factor to reach 81.9% in 2019 and 82.2% in 2020.
- Cargo and mail revenue to continue posting lower growth rates given that freighting services have been decreasing in the past two years. This revenue for these services to account for about 12% of total revenue for the next two years.
- Given new IFRS 19 accounting standards, operating costs to rise only 5% in 2019, compared with a 11.3% pace in 2018, as aircraft lease payments represented 6.3% of total COGS in 2018. On a comparative basis (eliminating leases from 2018 results), total operating costs to be 7.2% higher for 2019, mainly due to higher jet fuel consumption, maintenance obligations, and one-time impairment costs. Jet fuel costs to remain stable, given our forecast for benchmark crude oil Brent price of $60 per barrel for 2019 and 2020.
- Capital expenditures (capex) of $261 million for 2019 and $303 million for 2020. The company is now under a more cautious capex intensity mainly related to the company's reduction on fleet renewal intensity, which drove Avianca to increase debt funding, and lower cash flow generation in the past. Most of capex is for fleet maintenance and the remainder for aircraft renewals.
- A working capital shortfall totaling approximately $230 million in 2019 and 2020, mainly because of suppliers' collection on jet fuel, spare parts and maintenance services.
- Debt of about $5 billion for the next two years after the conclusion of debt restructuring. It will consist of the following: the exchange for the 9% notes due 2023 for up to $484.4 million; the remaining $65.6 million of the 8.375% notes due 2020; a $250 million loan from shareholders; $125 million in additional secured financing commitments; local bond for approximately $28 million due 2019; $3.4 billion in long-term bank loans and borrowings; About $1 billion in aircraft leases and other lease obligations.
- Dividends to remain $65 million - $75 million for the next two years.

Based on these assumptions, we arrive at the following credit measures:

- EBITDA margins of 16%-20% for 2020 and 2021.
- Debt to EBITDA slightly above 5.0x for the next two years;
- FFO to debt of about 10% and 15% in the next two years; and
- FFO cash interest coverage of 3%-4% for the next two years.

Liquidity

We continue to assess Avianca's liquidity as weak under our criteria, given that we expect the company's sources of liquidity to be lower than its uses in the next 12 months, reflecting a wide deficit. However, we still believe that Avianca has relatively solid relationships with banks in Colombia and its shareholders have a track record of extending financial support.

Principal liquidity sources:

- Cash and short-term investments of about $212 million as of Sept. 30, 2019;
- FFO of about $602 million for the next 12 months; and
- Asset sales of about $59 million in the next 12 months.

Principal liquidity uses:

- Short-term debt maturities of $551 million pro forma the completion of debt restructuring;
- Maintenance and committed capex of about $293 million for the next 12 months;
- Working capital outflows of about $105 million in the next 12 months; and
- Dividend payments of $72 million in the next 12 months.

Environmental, Social, And Governance

Environmental factors are part of our analysis of Avianca, particularly given increasing regulation of greenhouse gas emissions. However, this factor represents a low risk for the company. The guidelines under the International Civil Aviation Organization (a United Nations sponsored entity) in 2016 and Colombia's 2017 carbon tax aim to stabilize and reduce CO_2 emissions and improve airlines' fuel consumption. Avianca has pursued efforts to incorporate fuel-efficient aircraft and keep a relatively young fleet, which is about seven years, below those of most of its Latin American peers.

We assess inherent social risks for the transportation industry that could have an impact on the company's operations, including service and safety standards. Avianca is perceived as a company with high quality and service standards. However, the 2017 pilot strike took a toll on Avianca's reputation. The strike lasted for more than 50 days and disrupted the company's operations, increasing its overhead expenses, which resulted in the dismissal of about 700 pilots and cancellation of more than 3,000 flights. Avianca's commercial operations haven't experienced any accidents for several years, reflecting its high safety standards and in line with those of the industry.

We view Avianca's management and governance as fair, reflecting management's expertise, and depth and breadth. After the loan agreement between Synergy Corp., the airline's main shareholder, and United in November 2018, Avianca's corporate governance has strengthened thanks to the additional supervisory parties and new internal controls. However, we believe that Avianca's management and governance has failed to align its operating strategy to market conditions, as seen in the downgrade to 'SD' in the past. Avianca's governance faces higher risks, which we will continue evaluating.

Issue Ratings - Subordination Risk Analysis

Capital structure

As of Sept. 30, 2019, Avianca's capital structure primarily consisted of $3.4 billion in financial leases related to aircraft purchases and $1.1 billion in operating leases. The remaining amount consists of the rated senior unsecured notes due 2020 with an outstanding amount of $568 million. On a pro forma basis as of Dec. 31, 2019, 88.1% of this amount will consist of the new 9%

senior secured notes due 2023 and the remainder from the 8.375% senior unsecured notes due 2020.

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 Sept. 30, 2019, the outstanding amount of the term facility due 2022 was $409 million.

Analytical conclusions

We rate Avianca's 9% notes due 2023 at 'B-' because we assume that 77.4% of the company's corporate debt (about $4 billion) was secured as of Sept. 30, 2019. In addition, reflecting the subordination of the existing 8.375% notes due 2020, we rate them at 'CCC+'. Currently, Avianca's debt priority ratio is about 77.4% 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.

Ratings Score Snapshot

Issuer credit rating: B-/Stable/--

Business risk: Weak

- Industry risk: High
- Country risk: Moderately high
- Competitive position: Fair

Financial risk: Highly leveraged

- Cash flow/leverage: Highly leveraged

Anchor: b

Modifiers

- Diversification/portfolio effect: Neutral (No Impact)
- Capital structure: Neutral (No Impact)
- Liquidity: Weak (-1 notch)
- Financial policy: Neutral (No Impact)
- Management and governance: Fair (No Impact)
- Comparable rating analysis: Neutral (No Impact)

Stand-alone credit profile: b-

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

Not Rated Action

	To	From
Avianca Holdings S.A.		
Analytical Factors		
Local Currency	b-	SD

Upgraded

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

LifeMiles LTD		
Senior Secured	B+	B-
Upgraded; CreditWatch/Outlook Action		
	To	**From**
Avianca Holdings S.A.		
Issuer Credit Rating	B-/Stable/--	SD/--/--
	To	**From**
LifeMiles LTD		
Analytical Factors		
Local Currency	bb-	b

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.