FitchRatings

# Fitch Downgrades Avianca Holdings to 'B-' on Rating Watch Negative

Fitch Ratings-Chicago-12 June 2019: Fitch Ratings has downgraded Avianca Holdings S.A.'s Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) to 'B-' from 'B' and its USD550 million senior unsecured notes to 'CCC+'/'RR5' from 'B-'/RR5'. Fitch has placed all of Avianca's ratings on Rating Watch Negative. A full list of rating actions follows at the end of this release.

The rating downgrade reflects deterioration of Avianca's credit profile as a result of persistently high leverage ratios, limited financial flexibility and high refinancing risks. The ongoing macroeconomic and FX volatilities in the region associated with increasing competition from LCCs are negative headwinds and challenge the company's ability to improve leverage levels during 2019. Fitch expects Avianca's total debt/EBITDAR to be around 6.7x at 2019 and 6.3x by 2020, which compares to 6.6x in 2018 and 7.5x in 2017. The ratings also consider the vulnerability of the company's cash flow generation to fuel price variations and the inherent risks of the airline industry.

The Rating Watch Negative reflects the increasing refinancing risks the company faces with its USD550 million unsecured bonds due May 2020. As of March 31 2019, the company reported USD357 million of cash and USD626 million of short-term debt (excluding rental obligations). If the company is able to complete the bond refinancing, Fitch would consider removing the Rating Watch Negative.

The recent changes at the controlling shareholder level may help support the company in its refinancing efforts, but the terms and time of execution remain uncertain. Fitch views as positive the announcement from United Airlines, Inc. (United, IDR 'BB'/Stable) that it had exercised certain rights under the Loan Agreement (USD456 million) with BRW Aviation LLC (BRW), Avianca's main shareholders (78.1% of voting rights). United had granted independent authority to Kingsland Holdings Limited (Kingsland, 21.9%) as well as the offer of USD150 million in loans to Avianca, after certain conditions are met. Kingsland would also add USD100 million in financing. It is not clear yet the terms of the financial support, but this new credit line could help Avianca to succeed in its refinancing plan and maintain the company's rating at 'B-'.

KEY RATING DRIVERS

Change in Shareholder Structure: If executed as planned, the new shareholder structure at Avianca could be supportive to its refinancing strategy as well as to support its transformational plan. Fitch assesses Avianca on stand-alone basis, with no link to United's ratings, but the presence of United as a strategic partner and the USD150 million loan are credit positive. Avianca needs to amend contracts and request waivers from several ECAs (Export Credit Agency) that are the creditors on around USD1.1 billion of Avianca's debt (total of USD4 billion as of Dec. 31 2018). The amendments and waivers refer to changes in the shareholder structure: add United as permitted holder of Avianca' shares and removal of Synergy Group from being a guarantor in the ECAs contracts.

Strong Regional Market Position: Avianca's business model combines operations in Colombia, Central and

South America, allowing it to rotate capacity according to market conditions. Its geographic diversification allows the company to maintain consistently solid average load factors of 82% during 2015-2018. The company's business diversification is viewed as adequate with international passengers, domestic passengers, cargo operations, and the loyalty program and other segments representing approximately 42%, 41%, 13%, and 4% of its total revenues. Avianca's dominant position in the Colombian market is positively incorporated into the ratings. The announcement of a joint business agreement with United and Copa Airlines (not rated) should only benefit Avianca's competitive business position in the medium to long term. Regulatory approval for this transaction is expected to take approximately 12 to 18 months.

Challenge to Improve EBIT Margins: Fitch expects Avianca's EBIT margin decrease about 5.5%-7.0% during 2019 and 2020, driven primarily by rationalization of its route network and several costs cutting initiatives. This compares with the 6.0% adjusted EBIT margin of 2018. Avianca has announced the removal of E190 aircrafts and eliminations of unprofitable routes, mainly in Peru and in selected regional markets in Colombia, while focusing on its points of network strength. Higher fuel prices and currency devaluation(s) remain as ongoing concerns. The scenario of increasing competition from smaller players in Avianca's main markets is a concern and may pressure the company's solid load factor and yields levels, as observed during 1Q19.

Fleet Management Key to Restore FCF: Avianca's strategy to rightsizing its fleet delivery plan is key to improving its cash flow generation. The high capex level of USD659 million in 2018 was a major driver for the negative FCF of USD248 million during 2018. The company announced the revision of its aircraft backlog, aiming to defer up to 35 narrow-body aircraft while cancelling the delivery of another 17. In its base case scenario, Fitch forecasts Avianca's FCF to be neutral to slightly negative during 2019 and 2020, up to USD50 million negative. Capex for 2019 and 2020 is expected to be USD441 million and USD500 million, respectively. Fitch also expects Avianca to remain disciplined on its dividends distributions, maintaining minimum level payouts to avoid further leverage deterioration.

Leverage to Decline By 2020: Avianca's high leverage has pressured its ratings, and the challenging operating environment in 2019 should delay any deleveraging to 2020. Fitch expects Avianca's total adjusted leverage to improve to around 6.3x by 2020 from 6.7x in 2019. Avianca's total adjusted debt/EBITDAR was 6.6x during 2018 and 7.5x in 2017. Fitch base case does not incorporate any major non-core assets sales besides those already announced, including the Embraer's fleet.

High Refinancing Risks: Avianca's ability to proceed with their refinancing plan is crucial to avoid an additional downgrade. As of March 31, 2019, the company had USD357 million in cash. USD626 million of debt will come due in the short term (excluding operating leases), and USD568 million of its unsecured notes are due in May 2020. Excluding the bonds, the majority of its obligations are aircraft related, which the company is expected to refinance with ongoing secured loans. Fitch considers that the company has some financial flexibility to raise additional cash using part of its unencumbered aircraft fleet. Nonetheless, ongoing discussion at the shareholder level has led to some uncertainties and concerns that the company's debt will be impacted by changes of control clauses.

Credit Linkages and Notes' Guarantees Structure Incorporated: The ratings also reflect Avianca's corporate structure and credit linkage with its subsidiaries, Aerovias del Continente Americano S.A. (Avianca) and Grupo Taca. Combined, these two operating companies represent the main source of cash flow generation for the holding company. The significant legal and operational linkages between the two operating companies are reflected in the existence of cross-guarantee and cross-default clauses relating to the financing of aircraft acquisitions for both companies.

DERIVATION SUMMARY

Avianca is well positioned in the 'B' rating category relative to its regional peers based on its network, route diversification and important regional market position. Nevertheless, these factors are tempered by the company's higher gross adjusted leverage and refinancing risks, weaker liquidity and financial flexibility relative to peers. Avianca's 'B-' rating is below LATAM Airlines S.A. (LATAM, B+/Positive) and GOL Linhas Aereas Inteligentes S.A. (GOL, B/Stable), which have recently showed improvements in credit metrics. The ratings distinction among the three airlines reflects differences in the financial strategies, credit access, operational performance volatility and business diversification.

Avianca's 2018 adjusted EBIT margin of 6% compares poorly to 9% and 7% for GOL and LATAM, respectively. Fitch expects Avianca to maintain operational margins in the 5.5% to 7.0% range during 2019-2020. These levels are below those expected for LATAM and GOL during the same period. Avianca's ratings are constrained by its high gross adjusted leverage (6.6x), which is at the high end of its peer group. LATAM and GOL ended 2018 with gross adjusted leverage metrics of 5.0x and 5.8x, respectively.

Avianca has maintained a low cash position relative to its annual revenues. Given the company's limited financial flexibility at the moment, the percentage has declined to 7%. This level is below Fitch's previous expectation of 12% for 2019. This liquidity position is lower than those levels expected by LATAM (18%) and GOL (15%) during the same period. Due to its debt payment schedule and currently limited access to capital market, Fitch views Avianca Holdings' financial flexibility as weaker than LATAM and GOL.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer
--Neutral to low single-digit yield growth;
--Load factor in the 80%-82% range;
--2019-2020 EBIT margin moving around 5.5%-7.0%;
--Capex of USD441 million in 2019 and USD500million in 2020

KEY RECOVERY RATING ASSUMPTIONS
-The recovery analysis is based on a liquidation approach given the high value of its aircraft fleet, which positively compares to the going concern approach.
-Fitch has assumed a 10% administrative claim.

Liquidation Approach:
-The liquidation estimate reflects Fitch's view of the value of aircraft and other assets that can be realized in advance rate of 70%, 75% account receivables due high percentage of credit card receivables and 50% inventories.
- These assumptions result in a recovery rate for the unsecured bonds within the 'RR5' range, which generates a one-notch downgrade to the debt rating from the IDR.

RATING SENSITIVITIES

Developments That May, Individually or Collectively, Lead to Positive Rating Action

Fitch would review the Rating Watch Negative if the company successfully completes the refinancing of its USD550 million senior unsecured notes.

--Adjusted gross leverage below 6.5x on sustainable basis;
--EBIT margin consistently above 6.5%;
--Coverage ratio, measured as total EBITDAR/(interest expense plus rents) ratio, consistently above 2x;
--Liquidity, cash/LTM revenues, consistently above 10%.

Developments That May, Individually or Collectively, Lead to Negative Rating Action
--Failure to proceed with current refinancing strategies in order to reduce the high refinancing risks;
--Adjusted gross leverage above 7.5x;
--EBIT margin consistently below 5%;
--Coverage ratio, measured as the total EBITDAR/(interest expense + rents), consistently below 1.5x;
--Liquidity, cash/ LTM revenues, consistently below 8%.

LIQUIDITY

Limited Financial Flexibility: As of March 31, 2019, the company had USD357 million in cash. USD626 million of debt will come due in the short term (excluding operating leases), and USD568 million of its unsecured notes are due in May 2020. Total adjusted debt was USD5.9 billion at YE 2018. Debt consists primarily of USD4 billion of on-balance-sheet debt, most of which is secured, and an estimated USD1.9 billion of off-balance-sheet debt associated with lease obligations, per Fitch's criteria. Avianca's cash position in percentage of its last 12 months has deteriorated to 7.3% as March 31 2019 from 10.3% in December 2018.

FULL LIST OF RATING ACTIONS

Fitch has downgraded and placed the following ratings on Rating Watch Negative:

Avianca Holdings S.A.
--Long-Term Issuer Default Rating (IDR) to 'B-' from 'B';
--Long-Term Local Currency IDR to 'B-' from 'B';
--USD550 million unsecured notes due in 2020 to 'CCC+'/'RR5' from 'B-'/'RR5'.

Aerovias del Continente Americano S.A.
--Long-Term IDR to 'B-' from 'B';
--Long-Term Local Currency IDR to 'B-' from 'B'.

Grupo Taca Holdings Limited
--Long-Term IDR to 'B-' from 'B'.

Avianca Holdings, Grupo Taca, and Avianca Leasing are co-issuers of the USD550 million unsecured notes.

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Additional information is available on www.fitchratings.com. For regulatory purposes in various jurisdictions, the supervisory analyst named above is deemed to be the primary analyst for this issuer; the principal analyst is deemed to be the secondary.

Applicable Criteria
Corporate Rating Criteria (pub. 19 Feb 2019)
Corporates Notching and Recovery Ratings Criteria (pub. 23 Mar 2018)
National Scale Ratings Criteria (pub. 18 Jul 2018)
Parent and Subsidiary Rating Linkage (pub. 16 Jul 2018)

Additional Disclosures
Dodd-Frank Rating Information Disclosure Form
Solicitation Status
Endorsement Policy

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