

FITCH AFFIRMS AVIANCA HOLDINGS S.A.'S IDRS AT 'B'; OUTLOOK REVISED TO STABLE

Fitch Ratings-New York-15 March 2018: Fitch Ratings has affirmed Avianca Holdings S.A.'s (Avianca Holdings) Issuer Default Rating at 'B' and revised its Rating Outlook to Stable from Negative. Fitch has also affirmed the company's existing unsecured notes ratings at 'B-'/RR5'. A full list of ratings is shown at the end of this release.

The Outlook revision encompasses Avianca Holdings' capacity to maintain liquidity, leverage and margin metrics despite a very challenging environment in 2017 at levels in line with expectations previously incorporated in the ratings. The revision is also aided by prospects of Avianca Holdings' operational performance to continue benefiting from positive traffic trend in its main markets during 2018-2019. The Stable Outlook is supported by Fitch's expectations that Avianca Holdings will lower its adjusted gross leverage toward 2019.

Fitch's primary concerns revolve around Avianca Holdings' liquidity position and growth strategy, which will require material spending on aircraft deliveries over the next few years. The increased aircraft related capex is a critical part of Avianca Holdings' capacity plans, but it could pressure on FCF over the intermediate term and lead to incremental borrowing.

The 'B-'/RR5' Recovery Rating of the company's unsecured notes incorporates the subordination of the notes to the significant levels of secured debt, resulting in below average recovery prospects in the event of default. 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, as well as the carrier's capacity to maintain operational margins based on the leader position in the markets where it operates.

KEY RATING DRIVERS

Strike Impact in Credit Metrics Incorporated: In 2017 Avianca Holdings' operations faced a pilot strike from Sept. 20 until Nov. 13. This event reversed the positive trend observed in the company's operational margin and leverage metrics during the LTM ended in September 2017. Despite the pilot strike and its effects on fourth quarter 2017 passengers transported, which declined by 13.7%, year on year, the company was able to adjust its operations and transport 30 million passengers in 2017, similar to 2016 traffic levels. The company's 2017 operational result was USD293 million, and Avianca Holdings estimates the negative impact of the pilot strike in the company's operational results at approximately USD126 million.

EBIT Margin in 6% to 7% Range: Avianca Holdings' 2017 EBIT margin was 6.6%, slightly below 2016's margin of 7.2. Fitch expects the EBIT margin for 2018 to 2019 to remain stable at around 6.5%, driven primarily by single digit growth in traffic, higher yields, and the increase in cargo activity. These positive factors should be partially counterbalanced by expected increase in fuel cost during the period. The total capacity, measured as available seat kilometres, is anticipated to increase 8% to 10% during 2018 as the company operations recovers from the pilot strike impact in 2017.

High Gross Adjusted Leverage: The company's gross adjusted leverage, as measured by total adjusted debt/EBITDAR, remained high at 6.4x at the end of December 2017 versus 6.2x at year-end 2016. Fitch expects the company's gross adjusted leverage ratio to be around 6.4x and 5.7x in

2018 and 2019, respectively. Avianca Holdings' cash flow generation, as measured by EBITDAR, was USD885 million during 2017. The company held approximately USD5.7 billion in total adjusted debt at year-end 2017. Debt, as of Dec. 31, 2017, consists primarily of USD3.7 billion of on-balance-sheet debt, most of which is secured, and an estimated USD2 billion of off-balance-sheet debt associated with lease obligations.

Capex Management Key for FCF and Deleverage: Fitch considers the company's capex levels and resulting FCF generation will be crucial for its financial leverage trend during the next 24 months ended in December 2019. During the LTM ended September 2017, the company's FCF generation was positive USD110 million, resulting in FCF margin (FCF/ revenues) of positive 2.5%. The company's LTM September 2017 positive FCF resulted primarily from its better operational performance with an EBIT margin of 7.1% during this period. The LTM September 2017 FCF calculation reflects USD443 million in cash flow from operations, USD281 million in net capex and USD51 million in paid dividends. Fitch expects Avianca Holdings to manage its capital intensity, measured as the capex/revenue ratio, in the 6% to 10% range during 2017 -- 2019. Fitch forecast the company to reach slightly negative to neutral FCF during 2017-2019.

Limited Visibility on Potential Events; Not Incorporated in Ratings: Avianca Holdings' ratings do not factor in several potential events including the incorporation of a strategic partner, the execution of an equity increase, and/or merger and acquisition activity-related operations in the Brazilian market. Fitch considers there to be limited visibility at this point as to final outcomes and timing of each of these events but that in general the incorporation of a global carrier as a strategic partner could be a positive development. The move would allow Avianca Holdings to strengthen key areas such as market position and corporate governance.

Credit Linkages and Notes' Guarantees Structure Incorporated: The ratings also reflect Avianca Holdings' 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. Avianca Holdings, Grupo Taca, and Avianca Leasing are jointly and severally liable under the USD550 million unsecured notes as co-issuers. Avianca Leasing is a wholly owned subsidiary incorporated under the laws of the state of Delaware, whose obligations as a co-issuer of the notes are unconditionally guaranteed on an unsecured, senior basis by Avianca for up to two-thirds of the total issuance amount.

DERIVATION SUMMARY

Avianca Holdings is well positioned in the 'B' rating category relative to its regional peers given its network, route diversification, important regional market position and relatively more stable operational performance. These positive factors are tempered by the company's higher gross adjusted leverage and weaker liquidity relative to peers. Avianca Holdings' 'B' rating is below LATAM Airlines S.A. (LATAM, B+) and at the same level as GOL Linhas Aereas Inteligentes S.A. (GOL, B). The ratings distinction among the three airlines reflects differences in the financial strategies, credit access, operational performance volatility and business diversification for each airline.

For 2017, Avianca Holdings generated EBIT margins of 6.6% compared to levels of 9.4% and 7% for GOL and LATAM, respectively. Avianca Holdings is expected to maintain operational margins in the 6% to 7% range during 2018 to 2019. These levels are below to those expected for LATAM and GOL during the same period. Avianca Holdings' ratings are constrained by its high gross adjusted leverage. Avianca Holdings' gross adjusted leverage of 6.4x as of Dec. 31,

2017 is at the high end of its peer group. LATAM and GOL ended 2017 with gross adjusted leverage metrics of 5.2x and 5.6x, respectively.

Avianca Holdings has maintained a cash position relatively low to its annual revenues. Fitch expects the company to maintain a liquidity position of approximately 12% of its expected annual revenues levels in 2018. 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 expected aircraft capex levels, Fitch views Avianca Holdings' financial flexibility as lower than those observed for LATAM and GOL.

KEY ASSUMPTIONS

Fitch's Key Assumptions within Our Rating Case for the Issuer

- 2018-2019 EBIT margin approximately at 6.5%;
- 2018-2019 gross adjusted leverage, measured as total adjusted debt/EBITDAR ratio, around 6x, 6.4x in 2018;
- 2018-2019 coverage ratio, EBITDAR/(net interest expense + rents), around 1.9x;
- 2017 liquidity, measured as the readily available cash over LTM net revenues, around 12%;
- 2018-2019 FCF generation slightly negative.

RATING SENSITIVITIES

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

- Adjusted gross leverage trending to around 5x;
- EBIT margin consistently above 7%;
- Coverage ratio, measured as total EBITDAR/(interest expense plus rents) ratio, consistently above 2.3x;
- Liquidity, cash/ LTM revenues, consistently above 12%;
- Moving toward neutral-to-positive FCF.

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

- Adjusted gross leverage remaining above 6.5x;
- EBIT margin consistently below 6%;
- Coverage ratio, measured as the total EBITDAR/(interest expense + rents), consistently below 2x;
- Liquidity, cash/ LTM revenues, consistently below 10%;
- Sustained negative FCF.

LIQUIDITY

Moderated Improvement in Liquidity, Debt Payment Schedule Limit Financial Flexibility: Fitch views as a positive the company's recent increase in liquidity. As of Dec. 31, 2017, Avianca Holdings had cash and equivalents of USD514 million (USD375 million as of Dec. 31, 2016), the company does not maintain unused committed credit lines. Liquidity, measured as total cash and equivalents, represented around 12% of its revenues in 2017 from 9% in 2016. Upcoming debt maturities are relatively high for the company's liquidity and expected FCF generation during 2018 -- 2019. Debt maturities during 2018 and 2019 are USD572 million and USD411 million, respectively. Fitch expects Avianca Holdings to cover its capex and debt maturities with a combination of its own cash flow generation, debt refinancing, and some incremental debt during 2018 -- 2019.

FULL LIST OF RATING ACTIONS

Fitch has affirmed the ratings for Avianca Holdings and its subsidiaries as follows:

Avianca Holdings S.A. (Avianca Holdings):

- Long-Term Issuer Default Rating (IDR) at 'B';
- Long-Term Local Currency IDR at 'B';
- USD550 million unsecured notes due in 2020 at 'B-/RR5'.

Aerovias del Continente Americano S.A. (Avianca):

- Long-Term IDR at 'B';
- Long-Term Local Currency IDR at 'B'.

Grupo Taca Holdings Limited (Grupo Taca):

- Long-Term IDR at 'B'.

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

The Rating Outlook was revised to Stable from Negative.

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Summary of Financial Statement Adjustments - Financial statement adjustments that depart materially from those contained in the published financial statements of the relevant rated entity or obligor are as follows:

- Operational lease adjusted debt.

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Applicable Criteria

Corporate Rating Criteria (pub. 07 Aug 2017)

<https://www.fitchratings.com/site/re/901296>
Exposure Draft: Corporate Rating Criteria (pub. 14 Dec 2017)
<https://www.fitchratings.com/site/re/907387>
Exposure Draft: Sector Navigators (pub. 21 Dec 2017)
<https://www.fitchratings.com/site/re/914221>
National Scale Ratings Criteria (pub. 07 Mar 2017)
<https://www.fitchratings.com/site/re/895106>
Parent and Subsidiary Rating Linkage (pub. 15 Feb 2018)
<https://www.fitchratings.com/site/re/10019836>

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