

FITCH DOWNGRADES AVIANCA HOLDINGS S.A.'S IDRS TO 'B'; OUTLOOK REMAINS NEGATIVE

Fitch Ratings-New York-24 March 2016: Fitch Ratings has downgraded the ratings for Avianca Holdings and its subsidiaries as follows:

Avianca Holdings S.A. (Avianca Holdings):

- Long-term Issuer Default Rating (IDR) to 'B' from 'BB-';
- Long-term local currency IDR to 'B' from 'BB-';
- USD550 million unsecured notes due in 2020 to 'B-/RR5' from 'B+/RR5'.

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

- Long-term IDR to 'B' from 'BB-';
- Long-term local currency IDR to 'B' from 'BB-';

Grupo Taca Holdings Limited (Grupo Taca):

- Long-term IDR to 'B' from 'BB-'.

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

The Rating Outlook remains Negative.

The rating downgrade reflects Avianca Holding's ongoing financial profile deterioration amid a difficult operating environment, and Fitch's view that any material recovery in its credit profile will remain challenging in the short to medium term. The company's gross adjusted leverage trend during the last 24 months has been worse than Fitch's previous expectation, with its total adjusted debt/EBITDAR reaching 7.4x at end-2015. Fitch previously forecasted the company's leverage to be in the range of 5.0-5.5x during 2015 followed by additional deleveraging over the medium term.

The Negative Outlook reflects Fitch's views that Avianca Holdings' gross adjusted leverage and operating margins will remain weak for the rating category during the next 12 to 18 months due to the current macro and business conditions prevailing in its main markets. In addition, the Negative Outlook also incorporates a review of Avianca Holdings' weakening credit metrics compared to its global peers within the rating category.

The ratings incorporate Avianca Holdings' regional market position as the lead carrier in Colombia and Central America, and its geographic diversification. 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. A positive factor in the ratings is the company's ability to maintain its liquidity position - through the monetization of assets sales - during 2015.

The 'B-/RR5' recovery rating of the company's unsecured notes incorporates the subordination of the company's unsecured notes with respect to significant levels of secured debt, resulting in below-average-recovery prospects in the event of default. The unsecured notes are co-issued by Avianca Holdings, Grupo TACA Ltd, and Avianca Leasing LLC.

KEY RATING DRIVERS

High Adjusted Gross Leverage (7.4x):

Avianca Holdings' financial leverage has deteriorated during the last two years as a result of increasing debt levels and declining operational performance. The company's gross adjusted leverage, as measured by total adjusted debt/EBITDAR was 7.4x at the end of December 2015. This level represents a continued deterioration over the 2013 and 2014 adjusted gross leverage metrics of 5x and 6.8x, respectively. Fitch expects the company's gross adjusted leverage ratio to trend to levels around 7.2x by the end of 2016 driven by better operational margins, which is still deemed weak for the rating category.

The company's cash flow generation, as measured by EBITDAR was USD767 million during 2015, similar to USD777 million during the 2014, with a 2015 EBITDAR margin of 17.6%. The company had approximately USD5.7 billion in total adjusted debt at the end of December 2015, which was an increase from USD5.3 billion and USD4.2 billion in adjusted debt as of Dec. 31 2014 and Dec. 31, 2013, respectively. The company's debt, as of Dec. 31, 2015, consists primarily of USD3.5 billion of on-balance-sheet debt, most of which is secured, and an estimated USD2.2 billion of off-balance-sheet debt associated with lease obligations. The company's rentals payments during 2015 were USD318 million (USD299 million in 2014).

Yields Remain under Pressure:

The company's 2015 EBIT margin fell to 5.1% (5.7% excluding one-off charges) from 2014 level of 6%. The decline in the company's operational margin in 2015 reflects more challenging macro and business environment faced by the company in its main markets due to strong currency depreciation and economic slowdown pressuring consumer spending. Avianca Holdings' 2015 operational margin was below Fitch's expectations, which incorporated initially an EBIT margin at around 9% for 2015.

The company's 2016 - 2017 EBIT margin is expected to be around 6.5% driven primarily by lower fuel cost and the company's continued efforts to reduce ex-fuel cost levels. Fitch views the company's capacity to manage its yields, avoiding material deterioration, as the key factor driving its 2016 operational performance. During 2016, the company's net revenue is expected to decline by around 8%, with lower yields offsetting a single-digit increase in the number of transported passengers. Avianca Holdings' 2015 average yield fell 18.6% compared to 2014. Fitch expects the company's yields to remain under pressure in 2016 as a result of continued weak macro and business environment. The company's passengers transported figure increased by 6.6% and 7.9% during 2014 and 2015, respectively, and it is expected to increase around 4.5% in 2016.

Capacity Adjustments and Capex Reduction Incorporated:

Key components in the company's business strategy during 2016 include a more moderate capacity increase, significant reduction in capital expenditures (capex) levels; and continued cost reduction efforts. Avianca Holdings' available seat kilometers were 38.8 billion, 41.2 billion and 44.5 billion in 2013, 2014 and 2015, respectively. These levels represented annual growth rates of 6%, 5.9%, and 8.3%, respectively. Avianca Holdings is targeting a more moderate capacity growth for 2016 in the 3%-5% range, slowing from levels observed in prior years. The lower target in terms of capacity growth for 2016 is oriented to improve the company's revenue and cost per capacity unit. The company's 2016 lower capacity target also incorporates its decision of reducing capital expenditures levels during 2016-2018.

Capex Continue to Limit FCF Generation:

During 2015, the company's Free Cash Flow (FCF) generation was negative USD160 million, resulting in FCF margin (LTM FCF/LTM revenues) of negative 3.7%. The 2015 FCF calculation reflects USD215 million, USD304 million; and USD71 million in cash flow from operations, net capex; and paid dividends, respectively. The company's 2015 negative FCF trend results primarily from its net capex, which represented approximately 7% of the total revenues during the period. Fitch expects the company to manage its capital intensity, measured as the capex/revenue ratio, at levels around 5.6%, 13%; and, 12% during 2016, 2017, and 2018 respectively. Fitch forecasts the company's 2016 FCF margin to be neutral to slightly positive, but to turn negative again during 2017 - 2018. The company's expected annual net capex levels during 2017 - 2018 will remain high at above USD500 million and limit its capacity to sustain positive FCF generation.

Liquidity Adequate for the Rating Category:

During 2015 the company executed the sale of a 30% stake in Avianca Holdings S.A.'s loyalty program to Advent International (Advent). In connection with this transaction Avianca Holdings S.A. received total proceeds of USD301 million. During 2015 the company recognized a loss of USD237 million due to its cash exposure in Venezuela. Fitch's liquidity analysis already excluded the company's cash exposure to Venezuela for the calculation of its readily available cash.

As of Dec. 31, 2015 Avianca Holdings had cash and equivalents balance of USD479 million, the company does not maintain unused committed credit lines. The company's liquidity, measured as total cash and equivalents represented 10% of LTM revenue as of Dec. 31, 2015, which Fitch considers to be adequate for the rating category. Upcoming debt maturities are high but manageable for the company's liquidity and expected free cash flow generation during the next 24 months. The company's debt maturities during 2016 and 2017 are US\$412 million and US\$358 million, respectively. Fitch expects Avianca Holdings to cover its capital expenditures and debt maturities with a combination of its own cash flow generation and further borrowing during 2016-2017.

Credit Linkages and Notes' Guarantees Structure Incorporated:

The ratings also reflect Avianca Holdings' corporate structure and the credit linkage with its subsidiaries, 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 related 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 Delaware, United States. Avianca Leasing's obligations as a co-issuer of the notes are unconditionally guaranteed on an unsecured, senior basis by Avianca up to 2/3 of the total issuance amount.

KEY ASSUMPTIONS

Fitch's key assumptions within the rating case for Avianca Holdings include:

- 2016 total transported passenger to increase around 4.5%;
- 2016 consolidated yield to decline in high single digit;
- 2016 net revenues to decline around 8%;
- 2016 EBIT margin approximately 6.3%;
- 2016 gross adjusted leverage, measured as total adjusted debt to EBITDAR ratio, around 7.2x;
- 2016 Coverage ratio, EBITDAR/(Interest Exp + Rents), around 1.75x;

- 2016 Liquidity, measured as the readily available cash over LTM net revenues ratio, around 10%;
- 2016 Net Capex levels around USD225 million;
- 2016 FCF generation neutral to slightly positive of around USD50 million.

RATING SENSITIVITIES

Considerations that could lead to a negative rating action (Rating or Outlook)

- Adjusted gross leverage remaining above 6.5x;
- EBIT margin consistently below 7%;
- Coverage ratio, measured as the total EBITDAR/(Int. Expenses + Rents) ratio, consistently below 2x;
- Liquidity, cash/ LTM revenues, consistently below 10%;
- Sustained negative free cash flow.

Considerations that could lead to a positive rating action (Rating or Outlook)

- Adjusted gross leverage trending to levels around 5x;
- EBIT margin consistently above 7%;
- Coverage ratio, measured as the total EBITDAR/(Int. Expenses + Rents) ratio, consistently above 2.25x;
- Liquidity, cash/ LTM revenues, consistently above 12%;
- Moving towards a neutral to positive free cash flow.

FULL LIST OF RATING ACTIONS

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The Rating Outlook remains Negative

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Applicable Criteria

Corporate Rating Methodology - Including Short-Term Ratings and Parent and Subsidiary Linkage
(pub. 17 Aug 2015)

https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=869362

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