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Research Update:

Avianca Holdings Outlook Revised To Stable From Positive, 'B+' Credit Rating Affirmed On Weaker Credit Metrics

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Overview

- Fiscal 2014 key credit metrics of Colombia-based airline Avianca were below our expectations.
- We are revising our outlook on Avianca to stable from positive.
- We are affirming our 'B+' corporate credit on the company and our 'B' issue-level rating on Avianca's $550 million senior unsecured notes due 2020.
- The stable outlook reflects our expectation that Avianca will maintain its credit metrics in line with its "aggressive" financial risk profile in the next two years despite challenging macroeconomic conditions in Latin America thanks to its leading position, increased operations, and cost-saving initiatives.

Rating Action

On May 5, 2015, Standard & Poor's Ratings Services revised its outlook on Avianca Holdings S.A. to stable from positive. At the same time, we affirmed our 'B+' corporate credit rating and our 'B' issue-level rating on the company's $550 million senior unsecured notes due 2020.

Rationale

The outlook revision reflects a lack of improvement in Avianca's key financial metrics as we had previously expected. This was mainly a result of redistribution of capacity, still high oil prices during most of 2014, and the impact of the devaluation of some Latin American currencies. Although we expect some improvements in the next few years, we expect Avianca's key credit metrics to remain in line with its "aggressive" financial risk profile.

Our issue rating on the notes is one notch lower than our corporate credit rating on Avianca, reflecting the structural subordination of the notes to existing secured debt. Under our criteria, operating leases and other aircraft financing are assumed to be senior secured obligations with priority of payment relative to unsecured debt. Currently, Avianca's secured debt represents about 35% of its total assets.

Avianca's "weak" business risk profile reflects the company's smaller size than those of its peers; the relatively small and competitive markets in which it operates; high geographic concentration of operations, particularly in Colombia with about 45% of total revenues; and inherent risks of the airline industry such as its cyclical nature that results in wide fluctuations in supply and demand, capital intensity, exposure to foreign exchange fluctuations, and the volatility in operating margins due to jet fuel price swings. In our view, the mitigating factors are Avianca's leading position in the airline markets where it operates; efficient and well-integrated operations; an increasingly larger, younger, and more efficient fleet; increased international and domestic routes and frequencies; stronger cargo business, frequent flyer program, and ancillary businesses; cost-savings initiatives, and favorable and more stable margins.

Our assessment of the company's "aggressive" financial risk profile reflects Avianca's mostly debt-financed growth strategy, significant fleet renewal, and expansion program that results in high capital expenditures and increased debt, leveraged capital structure, and its low, but improving, cash flow generation. In our opinion the company's margins will benefit from currently low oil prices, which should adjust gradually in the next two to three years.

For the 12 months ended Dec. 31, 2014, Avianca's consolidated debt to EBITDA was 5.3x, funds from operations (FFO) to debt was 13.1%, and EBITDA interest coverage was 3.5x, which were weaker than our expectations of less than 4.0x, about 21%, and about 5.0x, respectively. This stemmed from mainly from lower-than-expected sales growth due to challenging market conditions—such as foreign exchange devaluation, deployment of capacity, and continued decrease in fares--higher operating costs related mainly to ground operations, maintenance, repairs, and aircraft rentals and traffic; and additional debt related mostly to fleet financing.

Our base-case scenario assumes:

- Colombia's and Latin America's GDP growth of about 3.5% and of 0.8% in 2015 and 4.0% and 2.7% in 2016, respectively.
- Revenue growth of about 1% in 2015 due to the abovementioned factors and about 9% in 2016 mainly owing to the consolidation of expanded capacity, new routes, and cargo business, and improved macroeconomic conditions.
- Oil prices of $50-$70 per barrel and increasing year over year for the next three years, according to our price deck.
- EBITDA of about $950 million in 2015 and $1 billion in 2016 mainly due to lower fuel consumption--given depressed oil prices and a new fleet--lower maintenance and repair costs, and other operating efficiencies.
- Capital expenditures (capex) of about $840 million in 2015 and $620 million in 2016 with about 70% and 60% of these amounts for fleet renewal, respectively.
- Additional debt of about $800 million in 2015 and $350 million in 2016, 50%-70% of which is for fleet financing and the rest for other corporate projects.
- Dividend payment of about $38 million in 2015 and $42 million in 2016.

Based on the assumptions, we arrive at the following credit measures in 2015

and 2016:
- EBITDA margin of about 20%.
- Debt to EBITDA of 4.0x-4.5x.
- FFO to debt of 15%-20%.
- Free operating cash flow to debt of about -4% in 2015 and 5% in 2016.

Liquidity

We view Avianca's liquidity as "adequate," based on our view that the company's sources of liquidity will exceed its uses by at least 1.2x in 2015 and 2016 even if our forecasted EBITDA declines by 30%. Avianca currently holds approximately $281 million of cash in Venezuelan bank accounts, and we consider that it's highly unlikely for the company to repatriate those funds in the short term. Therefore, we are excluding that portion of cash from our analysis.

Principal liquidity sources:
- Cash and short-term investments of about $362 million as of Dec. 31, 2014, which excludes the portion trapped in Venezuela.
- Projected FFO of about $490 million in 2015.
- Contracted debt of about $35 million in 2015 for fleet renewal.

Principal liquidity uses:
- Debt payments of about $462 million in 2015.
- Working capital requirements of about $15 million in 2015.
- Capital expenditures of about $200 million in 2015 mostly used for maintenance purposes.
- Dividend payments of about $38 million in 2015.

Our liquidity analysis also incorporates qualitative factors, including our view that the company has a good relationship with local banks, good standing in the debt market, and generally prudent risk management.

Outlook

The stable outlook incorporates our expectation that the company will maintain its key credit ratios in line with its "aggressive" financial risk profile in the next two years, including debt to EBITDA of less than 5.0x and its FFO to debt well above 12%, amid Latin America's more challenging macroeconomic conditions.

Downside scenario

A downgrade is possible if adverse industry conditions, such as lower-than-expected economic growth, a prolonged spike in jet fuel prices, increased competition, or the incurrence of additional debt for fleet renewal program weaken the company's operating margins and debt to EBITDA to more than 5.0x on a sustained basis.

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 below 4.0x and FFO to debt above 20%.

Ratings Score Snapshot

Corporate Credit Rating: B+/Stable/--

Business Risk: Weak
- Country Risk: Moderately High
- Industry Risk: High
- Competitive Position: Fair

Financial Risk: Aggressive
- Cash Flow/Leverage: Aggressive

Anchor: 'b+'
Modifiers: No effect
- Diversification/Portfolio Effect: Neutral
- Capital Structure: Neutral
- Liquidity: Adequate
- Financial Policy: Neutral
- Management And Governance: Fair
- Comparable Rating Analysis: Neutral

Related Criteria And Research

Related Criteria

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Key Credit Factors For The Transportation Cyclical Industry, Feb. 12, 2014
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios and Adjustments, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Methodology: Industry Risk, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- 2008 Corporate Criteria: Rating Each Issue, April, 15, 2008

Ratings List

Ratings Affirmed

Avianca Holdings S.A.		
Senior Unsecured	B	

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Avianca Holdings S.A.		
Corporate Credit Rating	B+/Stable/--	B+/Positive/--

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