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Research Update:

Avianca Holdings S.A. 'B' Corporate Credit Rating Affirmed; Outlook Remains Stable

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Overview

- Colombian airline Avianca Holdings S.A. (Avianca) has improved its operating performance, thus stabilizing its credit metrics. The company's debt-financed fleet expansion, however, has weakened its liquidity.
- We are affirming our 'B' corporate credit rating on Avianca.
- At the same time, we are affirming our 'B-' issue-level rating on the company's $550 million senior unsecured notes due 2020.
- The stable outlook reflects our expectation that Avianca will have debt to EBITDA of about 5x, and funds from operations (FFO) to debt of about 14% in the next 12 months, which is commensurate with its debt-financed fleet expansion strategy. We expect that the company will maintain its margins mainly through continued operating efficiencies, the benefits of a newer fleet, and low jet fuel prices that will support its cost structure over the next two years.

Rating Action

On April 26, 2017, S&P Global Ratings affirmed the 'B' corporate credit rating on Avianca Holdings S.A. We also affirmed the 'B-' issue-level rating on the company's $550 million senior unsecured notes due 2020. The outlook is stable.

Rationale

The affirmation reflects our view that Avianca's credit metrics have been stabilizing as a result of improved operating performance. We expect that to continue in the next two years. Over that period we expect that the regional economy will improve modestly, foreign exchange volatility will ease, jet fuel prices will remain low, and the company will continue its initiatives to improve operating efficiency. Taken together, we expect these factors to result in more traffic and improved cash flow.

Avianca's operations continue to be concentrated in Latin America, particularly in Colombia, where it generates about 45% of total revenues. The company is, however, continuing its efforts to expand its routes and frequencies to North America and Europe using larger aircraft. Although Avianca is a relatively small airline, it holds a strong position in the markets where it operates—notably Colombia, Peru and Central America—thanks to favorable routes, frequencies, capacity, and load factors. The company's operations are efficient and well-integrated, and benefit from a fleet of larger, younger, and more efficient planes that have boosted available seat kilometers (ASK).

Our analysis of Avianca does not incorporate the potential strategic alliance with United Airlines Inc. (BB-/Positive/--) that the airlines announced in January 2017. Because the alliance is still in negotiation and subject to regulatory approval its impact on Avianca cannot yet be assessed. This alliance, however, could enhance the company's business model by increasing its network, routes, and frequencies, strengthening its competitive position, and introducing further operating efficiencies. In a similar vein, it is also too early to assess the impact on Avianca's credit metrics from a potential equity injection of up to $200 million from current shareholders, or from a potential combination of operations with Oceanair (Avianca Brasil).

In our view, although Avianca has rescheduled the delivery of new planes from Airbus to improve its cash flow, its liquidity has not benefited and has been weakened by the aircraft acquisitions and maintenance commitments.

Our issue-level 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.

We expect that Avianca's leverage metrics will continue to be relatively high during the next two years, mainly due to its debt-financed fleet expansion, which aims to improve the carrier's capacity and efficiency. However, we expect Avianca's metrics will gradually improve because of stronger cash flow, operating efficiencies from its newer fleet, and the consolidation of operations over new routes.

Our base case scenario assumes:

- GDP growth for Colombia and Latin America of about 2.2% and of 1.1% in 2017 and 2.4% and 2.1% in 2018, respectively. Overall, this modest demand growth is an improvement compared to expected 2016 GDP growth of 2% and -1.2%, respectively.
- Consumer price index (CPI) inflation in Colombia of 4.4% in 2017 and 4% in 2018, and an average foreign exchange rate of COP 3,000 in 2017 and COP 3,075 in 2018. CPI inflation indicates a downward trend that could contribute to stability in consumer prices and provide flexibility for fare increases, while reduced foreign exchange volatility will contribute to more stable demand.
- WTI and Brent crude oil price assumption of $50 per barrel for 2017 and 2018, and $55 per barrel thereafter. This means that in spite of the recovery of oil prices, jet fuel prices will remain low for the next few years, which benefits airline cost structures.
- Revenue growth of about 7% in 2017 and 9% in 2018 mainly driven by an improved regional economy, expanded capacity, increased passenger volume, ancillary business initiatives, consolidation of new international routes

(particularly Europe and South America), new routes and increased frequencies, and fare increases in both years of about 1% on domestic routes and 2.7% on international ones.
- EBITDA growth of about 9% in 2017 and 19% in 2018, reflecting low fuel prices, cost savings from a newer fleet with lower fuel and maintenance costs, and other operating efficiencies and cost controls.
- Capital spending of about $550 million in 2017 and $370 million in 2018, of which between 70%-80% will go toward fleet purposes and the remaining for corporate purposes.
- Dividend payments of about $47 million in 2017 and $44 million in 2018.
- Net additional debt of about $13 million in 2017, mostly for corporate purposes such as information technology projects.

Based on these assumptions, we arrive at the following credit measures for 2017 and 2018:
- EBITDA margins in the 20%-22.5% range;
- Debt to EBITDA of about 5x in 2017 and about 4x in 2018;
- FFO to debt of about 14% in 2017 and about 17% in 2018; and
- FFO cash interest coverage in the 5.5x-6.0x range.

Liquidity

We assess Avianca's liquidity as less than adequate, based on our view that the company's sources of liquidity will cover uses by less than 1.2x in the next 12 months, offering scant protection against unexpected adverse conditions, particularly those related to capital spending commitments associated with fleet maintenance and renewal.

Principal liquidity sources:
- Cash and short term investments of about $375.8 million at Dec. 31, 2016, adjusting for restricted cash;
- Available committed credit facilities of about $50 million; and
- Projected FFO of about $382 million for the following 12 months.

Principal liquidity uses (for the twelve months following Dec. 31, 2016):
- Debt maturities of about $407 million in 2017;
- Working capital outflows of about $17 million in 2017; and
- Capital spending requirements of about $448 million for fleet maintenance and renewal.

Our liquidity assessment incorporates our view that Avianca is likely unable to absorb low-probability adversities, even factoring in capital spending cuts, asset sales, and reduced shareholder distributions. Avianca's ability to delay or reduce capital spending is limited because of its commitments to fleet maintenance and renewal, as well as market conditions for sale-and-leaseback back transactions or aircraft sales. Although Avianca has ample headroom on its financial covenants and a generally high standing in credit markets, it does not have a particular core banking relationship.

Outlook

The stable outlook reflects our expectation that Avianca will post key credit metrics with a debt to EBITDA of about 5x and FFO to debt of about 14% in the next 12 months, commensurate with its debt-financed fleet expansion. We also expect that the company will continue to maintain its margins over the next two years mainly through continued operating efficiencies and benefits from its newer fleet and low jet fuel prices.

Downside scenario

We could downgrade the ratings if adverse industry conditions weaken the company's operating margins and lead to a deterioration of our liquidity assessment, an increase in debt to EBITDA levels of more than 7x, or FFO to debt below 6% on a sustained basis. The conditions leading us to such a conclusion would include lower-than-expected economic growth, foreign exchange volatility, a prolonged spike in jet fuel prices, increased competition, or the incurrence of additional debt for the fleet renewal program.

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 from debt to EBITDA of well below 5x and FFO to debt well above 12% on a sustained basis. That could result from stronger regional economic growth or COP appreciation against the dollar than we expect, or a significant reduction of debt. We could also upgrade the company's ratings if it strengthens it business profile by expanding its operations and competitive position, which could result from strategic alliances or organic growth.

Ratings Score Snapshot

Corporate 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
- Capital structure: Neutral
- Liquidity: Less than adequate

- Financial policy: Neutral
- Management and governance: Fair
- Comparable rating analysis: Neutral

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- 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 - General: Corporate Methodology: Ratios And Adjustments, 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: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Ratings List

Ratings Affirmed

Avianca Holdings S.A.	
Corporate Credit Rating	B/Stable/--
Avianca Holdings S.A.	
Senior Unsecured	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.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.