FitchRatings

Fitch Upgrades Avianca to 'CCC+'

Fitch Ratings - Chicago - 12 December 2019:

Fitch Ratings has upgraded Avianca Holdings' Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) to 'CCC+' from 'RD', and its secured bonds to 'CCC+'/'RR4' from 'C'/'RR4'.

The upgrades follow Avianca's announcement that it has completed its debt restructuring, including receipt of a USD250 million convertible secured stakeholder facility loan from United Airlines, Inc. (BB/Stable) and Kingsland Holdings Limited. Avianca has also announced an additional USD125 million in convertible secured financing commitments, still subject to certain conditions, from a pool of financial investors.

Avianca's credit profile has improved with the combination of enhanced liquidity and new debt profile amortization. This should better position the company to complete the turnaround of its operations and restore profitability levels. Further positive rating action remains subject to continued improvement in financial flexibility with sustainable access to credit lines, as well as improving operating cash flow generation to support deleveraging trend. Potential for shareholder tension remains a negative headwind for the ratings.

Key Rating Drivers

Mandatory Exchange Offer: The announcement that Avianca has renegotiated substantially all of its debt and lease obligations and reached agreements with key suppliers, allowed the company to complete the funding of the USD250 million four-year secured term loans, which are mandatorily convertible into Avianca Holdings shares subject to certain conditions. The satisfaction of precedent conditions outlined will automatically trigger the mandatory exchange of all USD484 million 8.375% senior secured notes due 2020 for an equivalent principal amount of 9.00% senior secured notes due 2023, which will occur on Dec. 31, 2019. The remaining balance of the 2020 unsecured bonds (USD66 million), not part of the exchange offer, is expected to be paid at maturity (May 2020).

Shareholder Tension Remains a Concern: Potential ramifications from the foreclosure process between Avianca's main shareholders may pose challenges for the company's long-term business strategy, and is a concern for the ratings. Since May 24, 2019, the control of Avianca was assumed by Kingsland Holdings Limited, which has 21.7% of Avianca's ordinary shares, and is an independent third party designated by United Airlines.

Strong Regional Market Position: Avianca's business model combines large operations in Colombia, Central and South America. Its geographic diversification allowed the company to rotate capacity within the region and 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. 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 adjusted EBIT margin to decrease to 4% in 2019 from 7% in 2018. Amidst a scenario of tough competition and currency depreciation, Avianca has been facing a decline in yields and this has been pressuring its operating margins. To face these challenges, the company is trying to cut costs by rationalizing its route network: it has announced the removal of its E190 aircraft fleet from service and is eliminating unprofitable routes, mainly in Peru and in selected regional markets in Colombia, while focusing on its points of network strengths.

High Leverage to Persist: Avianca's high leverage has pressured its ratings, and the challenging operating environment in 2019 likely prevents meaningful deleveraging to occur before YE 2020. Fitch expects Avianca's net adjusted debt/EBITDAR to increase to around 6.7x in 2019 and 6.3x in 2020. Avianca's total adjusted debt/EBITDAR was 6.6x during 2018 and 7.5x in 2017. Fitch's base case does not incorporate any major non-core asset sales besides those already announced, including the Embraer fleet.

Credit Linkages and Notes' Guarantee 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's 'CCC+' rating reflects its post-restructuring credit profile. In terms of business profile, the company has a good asset base and is relatively well positioned 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 rating is below LATAM Airlines S.A. (LATAM; BB-/Stable), Azul S.A. (BB-/Stable) 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.

Key Assumptions

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

--Slightly negative or neutral yield growth;

--Load factor in the 81%-83% range;

--2019-2020 adjusted EBIT margin moving around 3.5%-5.0%;

--Capex of USD320 million in 2019 and USD400 million 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% and 75% account receivables due high percentage of credit card receivables.

Fitch applies a waterfall analysis to the post-default enterprise value based on the relative claims of the debt in the capital structure. The agency's debt waterfall assumptions take into account the company's total debt at Sept. 30, 2019, considering pro forma basis the mandatory exchange offer. These assumptions result in a recovery rate for the secured bonds within the 'RR2' range, but due to the soft cap of Colombia at 'RR4', Avianca's senior secured notes due 2020 are rated at 'CCC+'/'RR4'. For the unsecured bonds, the recovery rate is within the 'RR6' range, which generates a two-notch downgrade to the debt rating from the IDR, 'CCC-'/'RR6'.

RATING SENSITIVITIES

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

--Improved financial flexibility with sustained access to credit lines;

--Sustained turnaround in Avianca's operating cash flow generation that drives deleveraging to net adjusted debt/EBITDAR consistently below 6.0x;

--Perception of closer strategic alignment and foreclosure resolution between Avianca's shareholders.

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

--Maintenance of this net leverage ratio above 7.5x during 2020;

--Recurring shareholder disputes that delay the expected positive trend in cash flow.

Liquidity and Debt Structure

Improvement in Liquidity: Avianca's liquidity is expected to improve with the inflow of USD250 million from the secured loan and potential addition of another USD125 million. This together with the re-profiling of its new debt reduces refinancing risks in the short term. As of Sept. 30, 2019, the company had USD212 million in cash and USD3.7 billion of debt coming due in the short term, considering the company was in restricted default with selected financial and aircraft debt and leasing obligations. Considering the debtrestructuring, Avianca should present a more smooth debt schedule amortization profile. The USD567 million of its unsecured notes are due in May 2020 but considering the mandatory exchange offer, USD484 million of this amount will be due in May 2023. As of Sept. 30, 2019, total adjusted debt was USD5.0 billion. Debt consists primarily of USD4.0 billion of financial debt, most of which is secured, and an estimated USD1.1 billion of debt associated with lease obligations.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of 3 - ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity.

Avianca Holdings S.A. has an ESG score of 4 for Group Structure due to its complex shareholder structure. The current developments with United and Kingsland, and other shareholders, adds complexity to the case.

Avianca Holdings S.A. has an ESG score of 4 for Labor Relations & Practices reflecting significant pilot strikes that affected the company.

RATING ACTIONS

ENTITY/DEBT	RATING	RECOVERY	PRIOR
Aerovias del Continente Americano S.A. (Avianca)	LT IDR CCC+ Upgrade		RD
	LC LT IDR CCC+ Upgrade		RD
Avianca Leasing LLC			
senior unsecured	LT CCC- Upgrade	RR6	C
Grupo TACA Holdings Limited	LT IDR CCC+ Upgrade		RD
senior unsecured	LT CCC- Upgrade	RR6	C
Avianca Holdings S.A.	LT IDR CCC+ Upgrade		RD
	LC LT IDR CCC+ Upgrade		RD
senior unsecured	LT CCC- Upgrade	RR6	C
senior secured	LT CCC+ Upgrade	RR4	C

Additional information is available on www.fitchratings.com

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Applicable Criteria

National Scale Ratings Criteria (pub. 18 Jul 2018)
Country-Specific Treatment of Recovery Ratings Criteria (pub. 18 Jan 2019)
Corporate Rating Criteria (pub. 19 Feb 2019)
Parent and Subsidiary Rating Linkage (pub. 27 Sep 2019)
Corporates Notching and Recovery Ratings Criteria (pub. 14 Oct 2019)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form
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