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Research Update:

Avianca Holdings S.A. Rated 'B+' And Its Proposed Senior Unsecured Notes Rated 'B', Outlook Stable

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Avianca Holdings S.A. Rated 'B+' And Its Proposed Senior Unsecured Notes Rated 'B', Outlook Stable

Overview

- We are assigning our 'B+' corporate credit rating to Colombia-based airline Avianca Holdings S.A.
- We are also assigning our 'B' rating to Avianca's proposed notes due 2023.
- The stable outlook reflects our expectation that Avianca will fund adequately its operations with internal cash generation, limiting potential additional debt.

Rating Action

On April, 25, 2013, Standard & Poor's Rating Services assigned its 'B+' corporate credit rating on Avianca Holdings S.A. (Avianca). At the same time, we assigned our 'B' rating to Avianca's proposed senior unsecured notes due 2023. The outlook is stable.

Rationale

The 'B+' corporate credit rating reflects Avianca's "weak" business risk profile, "aggressive" financial risk profile, and "adequate" liquidity.

The rating on the note is one notch lower than the corporate credit rating on Avianca, reflecting the effective subordination of the notes to existing secured debts. Under our criteria, operating leases and other aircraft financing are assumed to be senior secured obligations with priority of payment relative to unsecured debt. Avianca will use the proceeds from the issuance to capital expenditures, to extend the overall debt maturity profile.

Avianca's business risk profile is constrained by the company's relatively small size compared with its peers and markets, in our view, are also relatively small and where a more competitive environment may increase risk. The airline industry is cyclical, because it's capital intensive and subject to wide fluctuations in both supply and demand, and volatile, because operating margins are very sensitive to swings in jet fuel prices. On the positive side, the company's business risk profile also incorporates Avianca's leading position in the regions where it operates, an efficient and well-integrated operation, and favorable and more stable profitability than of

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its larger peers.

Although we assume favorable growth trends in the countries that Avianca services, these markets are relatively small and demand patterns may be volatile depending on macroeconomic trends, in our view. We believe economies of scale and scope are still constraining rating factors, but Avianca is striving to improve its fleet size and composition. Avianca operates in several countries in Central America and South America, but we believe many demand drivers in the region tend to move in tandem, which constrains its geographic diversification. All main countries, which Avianca serves, either operate under, or are moving towards, Open Skies regulations, resulting in potentially greater competition in the next few years.

Nevertheless, demand fundamentals in these countries remain positive, as economic growth in the Andean region has been strong, and we believe it will remain favorable in the next few years. Since its successful merger with Taca in 2010, when it managed to maintain profitability even during the integration process, Avianca has operated a well-managed route network. Its efficient yield management has resulted in load factors and profitability that are stronger than those of most of its regional peers. The merger also provided Avianca with three hubs in the region (Bogota, Lima, and San Salvador) that allow the company to offer convenient connectivity and reach long-haul destinations in both North America and South America. The company is also dominant in Colombian market and in intra-Central America routes. Its market position in flights to and from Peru and Ecuador is also growing, as is its long-haul operations to Europe, which are particularly profitable.

Our base-case scenario assumes that Avianca will undertake a significant fleet renewal and expansion program in the next few years, which will pressure its credit metrics as new debt is raised. The company expects to invest more than $1.5 billion in the next two years. The newer, expanded fleet will provide Avianca with more fuel-efficient aircraft and more flexibility to manage and optimize its fleet network, which may result in stronger profitability than in our base case. Although we assume Avianca will be successful at securing financing for its aircraft purchases, we believe credit metrics will be somewhat weak, with operating lease adjusted (OLA) debt to EBITDA at about 5.0x in 2013 and 2014, and OLA funds from operations (FFO) to total debt of about 20%. Considering that the airline industry is volatile and capital intensive, downside risks to our base case include slower economic growth in Avianca's key markets, increased competition (especially in Colombia and Central America, where it may compete with larger airlines), and higher jet fuel and other operating costs. Still, credit metrics may strengthen if Avianca manages to capture higher synergies while market conditions remain sanguine in the next few years.

Our base-case assumptions include growth and profitability compatible with the company's recent historical performance, with above-aveoutrage growth in revenue passenger kilometers of 6%-7% and growth in its capacity of similar magnitude, and its capacity use of about 80%. We expect that average ticket prices will remain stable in 2013. Using our forecast of WTI oil of about

$90/barrel, fuel costs can actually decrease by about 2%-4% in 2013. Conservatively, we do not incorporate further synergy gains, as expected by the company, but with the elimination of 2012 non-recurring items, we expect EBITDA margin to increase to 13%-14%.

Liquidity

We consider Avianca's liquidity to be "adequate" under our criteria. We forecast that Avianca's sources of funds will exceed its uses by more than 1.2x in the next 12-24 months. The main sources of liquidity are:

- Reported cash available of $461 million;
- Expected FFO of $500 million in 2013; and
- Aircraft financing of $350 million in 2013.

The main uses are:

- Debt amortization of $280 million; and
- Capex of $600 million.

Outlook

The stable outlook is based on our expectation that the company will continue to generate above-average growth and improve operating profitability, but will maintain currently high leverage ratios as a result of its significant fleet renewal plan for the next 12-18 months. An upgrade is possible if the company's cash flow generation is higher than expected, due to stronger growth or improved profitability, resulting in OLA debt to EBITDA of less than 4.5x and FFO to total debt of more than 20%. A downgrade is possible, if competition increases and ticket prices decline, resulting in lower cash flow generation and leverage ratios above 6x. Higher fuel costs for a long period could also hurt the company's operations and result in a downgrade.

Related Criteria And Research

- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, Sept. 18, 2012
- Key Credit Factors: Criteria For Rating The Airline Industry, Oct. 22, 2010
- Corporate Ratings Criteria 2008, April 15, 2008

Ratings List

New Rating

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

Avianca Holdings S.A.
Avianca Leasing LLC
Grupo Taca Holdings Ltd.
 $300 mil senior unsecured notes due 2023   B

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