

## **FITCH AFFIRMS AVIANCA HOLDINGS S.A.'S IDRS AT 'B'; OUTLOOK REMAINS NEGATIVE**

Fitch Ratings-New York-17 March 2017: Fitch Ratings has affirmed the ratings for Avianca Holdings and its subsidiaries as follows:

Avianca Holdings S.A. (Avianca Holdings):

- Long-Term Issuer Default Rating (IDR) at 'B';
- Long-Term Local Currency IDR at 'B';
- USD550 million unsecured notes due in 2020 at 'B-/RR5'.

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

- Long-Term IDR at 'B';
- Long-Term Local Currency IDR at 'B';

Grupo Taca Holdings Limited (Grupo Taca):

- Long-term IDR at 'B'.

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

The Rating Outlook remains Negative.

The rating affirmation reflects Avianca Holding's improvements in profitability and leverage during 2016. The Negative Outlook reflects Fitch's views that Avianca Holdings' liquidity remains tight despite improved profitability. Avianca Holdings' pending debt maturities and scheduled capex levels are viewed as high with respect to its liquidity and expected FCF generation during 2017-2018.

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.

The 'B-/RR5' Recovery Rating of the company's unsecured notes incorporates the subordination of the notes to the significant levels of secured debt, resulting in below-average-recovery prospects in the event of default.

### **KEY RATING DRIVERS**

#### **Liquidity Remains Tight**

Fitch views the company's liquidity as low. As of Dec. 31, 2016, Avianca Holdings had cash and equivalents of USD375 million (USD479 million as of Dec. 31, 2015) and the company does not maintain unused committed credit lines. Liquidity, measured as total cash and equivalents, represented around 9.1% of its revenues in 2016. The company's capacity to generate positive FCF during 2017-2018 is expected to provide some improvement in its liquidity position. Upcoming debt maturities are relatively high for the company's liquidity and expected free cash flow generation during 2017-2018. Debt maturities during 2017 and 2018 are USD407 million and

USD385 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 2017-2018. The liquidity ratio, measured as total debt payments plus net capex levels to cash plus free cash flow generation during 2017-2018, is estimated at 0.7x.

### Improved Profitability

Avianca Holdings' 2016 adjusted EBIT margin increased to 7.2% from 2015's 5.7%. The EBIT margin for 2017-2018 is expected to be around 6.8% driven primarily by continued single-digit growth in traffic, stabilization in yields 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 one of the key factors driving its 2017 operational performance. Avianca Holdings' 2016 average yield fell 10% compared to 2015. During 2017, the company's net revenue is expected to increase by around 6%, with single-digit growth in the number of transported passengers.

### Lower Leverage

Avianca Holdings' adjusted gross financial leverage improved during 2016 compared to 2015 as a result of lower debt levels as the company was able to reduce on-balance-sheet debt by approximately USD200 million. The company's gross adjusted leverage, as measured by total adjusted debt/EBITDAR was 6.2x at the end of December 2016 versus 7.1x at the end of December 2015. Fitch expects the company's gross adjusted leverage ratio to be around 6x by the end of 2017. Avianca Holdings' cash flow generation, as measured by EBITDAR, was USD879 million during 2016. The company had approximately USD5.5 billion in total adjusted debt at the end of December 2016. Debt, as of Dec. 31, 2016, consists primarily of USD3.3 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 2016 were USD315 million.

### Capex Fleet Reduction Key for FCF:

During 2016, the company's FCF generation was positive USD210 million, resulting in FCF margin (FCF/ revenues) of positive 5.1%. The company's 2016 positive FCF resulted primarily from its better operational performance, a significant reduction in net capex, and lower paid dividends. The 2016 FCF calculation reflects USD418 million in cash flow from operations, USD176 million in net capex and USD32 million in paid dividends. Avianca Holdings has adjusted its net capex levels for 2017-2018 and is expected to manage its capital intensity, measured as the capex/revenue ratio, in the 5% to 2% range during 2017-2018. Fitch expects the company to reach positive FCF during 2017-2018.

### Limited Visibility on Potential Events; Not Incorporated in Ratings

Avianca Holdings' ratings do not factor in several potential events including the incorporation of a strategic partner, the execution of an equity increase, and/or merger and acquisition activity-related operations in the Brazilian market. Fitch considers there to be limited visibility at this point as to final outcomes and timing of each of these events, but that in general the incorporation of a global carrier as a strategic partner could be a positive development. The move would allow Avianca Holdings to strengthen key areas such as market position and corporate governance.

### Credit Linkages and Notes' Guarantees Structure Incorporated:

The ratings also reflect Avianca Holdings' 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 cashflow 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. 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, U.S. whose obligations as a co-issuer of the notes are unconditionally guaranteed on an unsecured, senior basis by Avianca for up to 2/3 of the total issuance amount.

## KEY ASSUMPTIONS

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

- 2017-2018 total transported passengers to grow around 5% per year;
- 2017-2018 EBIT margin approximately at 6.7%;
- 2017 gross adjusted leverage, measured as total adjusted debt/EBITDAR ratio, around 6x;
- 2017 coverage ratio, EBITDAR/(net interest expense + rents), around 1.9x;
- 2017 liquidity, measured as the readily available cash over LTM net revenues, around 9%;
- 2017-2018 FCF generation neutral to positive.

## 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 6%;
- Coverage ratio, measured as the total EBITDAR/(interest expense + rents), 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 around 5x;
- EBIT margin consistently above 7%;
- Coverage ratio, measured as total EBITDAR/(interest expense + rents) ratio, consistently above 2.25x;
- Liquidity, cash/ LTM revenues, consistently above 12%;
- Moving towards neutral-to-positive free cash flow.

## LIQUIDITY

Avianca Holdings' pending debt maturities and scheduled capex levels are viewed as high with respect to its liquidity and expected FCF generation during 2017-2018. 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 2017-2018.

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#### Applicable Criteria

Criteria for Rating Non-Financial Corporates (pub. 10 Mar 2017)

<https://www.fitchratings.com/site/re/895493>

National Scale Ratings Criteria (pub. 07 Mar 2017)

<https://www.fitchratings.com/site/re/895106>

Recovery Ratings and Notching Criteria for Non-Financial Corporate Issuers (pub. 21 Nov 2016)

<https://www.fitchratings.com/site/re/890199>

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