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Research Update:

Avianca Holdings S.A. Downgraded To 'B' From 'B+' On Higher Leverage And Weak Operating Performance; Outlook Stable

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Overview

- Colombia-based airline Avianca continues to face operating weaknesses in light of increasing macroeconomic risks and exchange rate volatility, which could further pressure the company's key credit metrics.
- We are lowering the corporate credit rating on the company 'B' from 'B+'.
- We are also lowering the issue-level rating on the company's senior unsecured notes to 'B-' from 'B'.
- The stable outlook reflects our view that Avianca's credit metrics will remain exposed to sluggish economic growth and a volatile exchange rate over the next 12 months, which would result in a highly leveraged financial risk profile with debt to EBITDA of about 5.0x and funds from operations (FFO) to debt slightly above 12%.

Rating Action

On April 13, 2016, Standard & Poor's Ratings Services lowered its corporate credit rating on Avianca Holdings S.A. to 'B' from 'B+'. The outlook is stable.

At the same time, we lowered our issue-level rating on the company's $550 million senior unsecured notes due 2020 to 'B-' from 'B'.

Rationale

The downgrade reflects continued weakness in the company's continued operating performance, leading to key credit metrics that fell short of our original expectations--around $764 million of EBITDA and $508 million of FFO, with a debt to EBITDA ratio of 5.9x and FFO to debt of 11.3x, respectively. Although, we project that financial performance would gradually improve in 2016, we believe its key credit metrics will be in line with a highly leveraged financial risk profile (debt to EBITDA roughly below 5.0x and FFO to debt of 13.5% over the next 12 months). In our opinion, its key credit metrics will continue to be highly exposed and sensitive to regional macroeconomic and foreign exchange conditions.

Avianca has faced a combination of challenges in 2015 and during the first quarter of 2016, including regional sluggish macroeconomic growth that

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impacted ticket demand and consumption patterns. It also faced exchange rate volatility with a 40% depreciation of the Colombian peso (COP) in 2015 (COP2,749) compared to 2014 (COP2,000 per U.S dollar). In our view, these challenges also hampered the company's ability to increase fares and to pass through costs to consumers, which hurt its margins.

By contrast, the global slump in fuel prices contributed to higher than expected cash flow generation and somewhat shielded margins—which fell short of our 17.5% expectations in 2015-- from foreign exchange weakness, lower consumer demand, among others. In our opinion, the company's margins will benefit from currently low oil prices, which should adjust gradually over the next two to three years. The company is implementing a cost reduction program and commercial initiatives; it's expanding capacity and routes, incorporating more-fuel efficient aircrafts, and other operating efficiencies. In our opinion, these measures will improve the company's operating performance. Nevertheless, the issuer will remain exposed to exogenous factors, such as macroeconomic slowdown and foreign exchange volatility.

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.

Avianca's business risk profile reflects the company's smaller size relative to its peers; the relatively small and competitive markets in which it operates; high geographic concentration of operations, particularly in Colombia (where it generates about 42% of total revenues); and the inherent risks of the airline industry. These risks include the industry's cyclical nature, characterized by 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; a stronger cargo business, frequent flyer program; and ancillary businesses.

Our assessment of the company's financial risk profile reflects Avianca's high leverage levels, given its debt-financed growth strategy, significant fleet renewal, and expansion program calls for high capital expenditures (Capex). It also reflects the issuer's still-low cash flow generation and more challenging markets conditions with the potential for a further macroeconomic slowdown and heightened foreign exchange volatility. For the 12 months ended Dec. 31, 2015, Avianca's consolidated debt to EBITDA was 5.9x, funds from operations (FFO) to debt was 11.3%, and FFO cash interest coverage was 5.2x, compared to 5.5x, 12.8x, and 5.9x, respectively, during the same period in 2014.

Our base-case scenario assumes:

- Colombia's and Latin America's GDP growth of about 2.6% and of -0.2% in 2016 and 3.3% and 2.1% in 2017, respectively, which overall indicates modest demand growth, in our opinion.
- Colombia's consumer price index (CPI) inflation of 5.8% in 2016 and 4.0% in 2017 compared to 5.0% in 2015, and a foreign exchange rate of COP3,250 in 2016 and 2017, compared to COP 2,749 in 2015. CPI inflation indicates some stability in consumer prices and will rein in fare increases, but foreign exchange volatility will continue to hurt demand thereof.
- WTI and Brent crude oil price assumption of $40 per barrel for 2016, $45 per barrel for 2017, and $50 per barrel thereafter. That means that jet fuel prices will remain at low levels for the next few years--which benefits airlines' cost structures. We're expecting gradual recovery in oil prices, however.
- As a result, revenues would decline of about 7% in 2016 mainly because of foreign exchange volatility, regional economic slowdown, and modest fare increases.
- Revenue growth of about 4% in 2017 due to a recovery in demand in the passenger and cargo businesses, some foreign exchange stability, and improved regional macroeconomic conditions. We'll see new routes and a continuous increase in passenger volume and capacity.
- EBITDA growth of about 12% in 2016 and of 7% in 2017, mainly due to: low fuel prices; operating efficiencies from a newer fleet with higher capacity and lower fuel consumption (eg. aerodynamics and engines); lower maintenance costs because of newer equipment; and other operating efficiencies and costs controls.
- Capex of about $220 million in 2016 and $550 million in 2017, all of which will go toward non-fleet corporate purposes in 2016, and about 45% for fleet renewal in 2017.
- Dividend payments of about $25 million in 2016 and $50 million in 2017.
- Additional debt of about $65 million in 2016 mostly for corporate projects and $260 million in 2017 mostly for fleet renewal.

Based on these assumptions, we arrive at the following credit measures for 2016 and 2017:

- EBITDA margins of around 21% in 2016 and 22% in 2016;
- Debt to EBITDA of about 5.0x;
- Funds from operations (FFO) to debt in the 13%-14%; and
- FFO cash interest coverage of about 5.0x.

Liquidity

We assess the company´s liquidity as adequate, based on our view that the company´s sources of liquidity will exceed its uses by 1.2x in 2016 and 2017 even if our forecasted EBITDA declines by 30%.

Avianca has a comfortable debt maturity profile, and we expect its cash flow generation to be sufficient to cover its working capital needs, and capex.

Principal Liquidity Sources:

- Cash and short term investments of about $484 million as of Dec. 31, 2015 adjusting restricted cash; and
- Projected FFO of about $373 million for the following 12 months.

Principal Liquidity Uses (for the 12 months following Dec. 31, 2015):
- Debt maturities of about $413 million in 2016;
- Working capital outflows of about $22 in 2016;
- Capex requirements of about $220 million to be used predominantly for non-fleet corporate purposes; and
- Dividend payments of about $25 million in 2016.

Outlook

The stable outlook reflects our view that Avianca's credit metrics will remain exposed to sluggish economic growth and a volatile exchange rate over the next 12 months, which would result in a highly leveraged financial risk profile with debt to EBITDA of about 5.0x and FFO to debt slightly above 12%.

Downside scenario

A downgrade is possible if adverse industry conditions--such as lower-than-expected economic growth and foreign exchange volatility, 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 lead to debt to EBITDA of more than 5.0x or FFO to debt below 12% 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 well below 5.0x and FFO to debt well above 12% as a consequence of improved conditions in the markets (such as a boost in regional economic growth or COP appreciation against the dollar).

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: 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

Downgraded

	To	From
Avianca Holdings S.A.		
Corporate Credit Rating	B/Stable/--	B+/Stable/--
Senior Unsecured	B-	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 Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.