11 DEC 2024

Fitch Affirms Avianca's IDR at 'B'; Outlook Stable

Fitch Ratings - Rio de Janeiro/Bogota - 11 Dec 2024: Fitch Ratings has affirmed Avianca Group International Limited's (Avianca) Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) at 'B' and Avianca MidCo2 Limited's senior secured exit notes at 'B' with a Recovery Rating of 'RR4'. Fitch has also affirmed LifeMiles Ltd.'s Long-Term Foreign and Local Currency IDR at 'B' and its secured Term Loan B due 2026 at 'B' with a Recovery Rating of 'RR4'. The corporate Rating Outlook is Stable.

Avianca's rating reflects the industry's high cyclicality risks, its solid market position in Latin America, lean cost structure, moderate leverage (net debt/adjusted EBITDA at 3.0x-4.0x within the rating horizon) and good liquidity position, though it has limited financial flexibility in terms of an unencumbered asset base. During 2024, the company has demonstrated good access to the credit market. Medium-term challenges for Avianca's include maintaining strong operating margins and resuming business growth in a more competitive environment.

Key Rating Drivers

Evolving Business Strategy: Avianca faces challenges in proving its new business model under varying macroeconomic scenarios and fuel prices environments. Since emerging from Chapter 11 in 2022, Avianca has been pursuing a more low-cost model, focusing on a simplified, cost-efficient narrow-body operation with high aircraft utilization rates and fleet densification with limited exceptions in terms of complementary widebody operations.

Recently, while navigating a challenging domestic market in Colombia, the company has focused on strengthening its international operations. Avianca has reintroduced business class services on its narrow-body international routes from Bogota (14 new destinations) and Medellin (three), and plans further routes increases by year-end, aiming to capture additional premium revenue with no material cost increase.

Diversified Regional Market Position: Avianca's business model combines a solid brand and large operations in Colombia, Central and South America. The company' sound international routes, cargo operations and loyalty program support an adequate business diversification. Avianca's flexible business model has allowed it to rotate capacity within the region and maintain solid load factors of 80%-82% over the past few years. During 2024, 43% of Avianca's revenue was Colombia, 20% U.S., 17% Central America, 15% other South American countries and 5% rest of the world.

Increasing Operations, Good Cost Structure: Fitch expects Avianca's operating cash flow to continue to improve in 2024 due to solid domestic traffic levels, relatively lower fuel prices, cost efficiencies and capacity expansion. We forecast adjusted EBITDAR around USD1.2 billion in 2024 and USD1.3 billion in 2025, an increase from USD523 million in 2019 (pre-pandemic). The efficient cost base is driving solid

EBITDAR margins, with our base case of 23.7% for 2024 and around22%-23% in 2025-2026, in a scenario of less favorable fuel prices and a fierce competitive environment.

Growth Appetite to Drive FCF: Avianca's stronger operating cash flow generation is likely to be consumed by fleet modernization and ongoing business growth. Fitch forecasts Avianca's FCF generation to be remain negative at USD98 million in 2024 and USD239 million negative in 2025 after increasing capex. We considered capex of USD437 million in 2024 and USD550 million in 2025 and 2026. Fitch expects Avianca to remain cautious regarding its inorganic growth strategy, as any M&A opportunities should be led by its parent company, ABRA Group Limited.

Manageable Leverage: Fitch's base-case scenario forecasts total and net-adjusted leverage/EBITDAR at around 4.3x and 3.3x, respectively, during 2024. That is a slight improvement from 4.4x and 3.5x, respectively in 2023, but significant progress from its Chapter 11 exit year in 2022 (6.2x and 5.0x, respectively). For 2025 and 2026, total and net leverage should remain near 4.3x and 3.5x, respectively. Avianca's ability to maintain these metrics below that within the next 18-24 months while successfully completing LifeMile's Term Loan B refinancing should benefit its credit profile assessment.

Limited Financial Flexibility: The ability to access new credit lines, seeking to refinance short- to medium-term obligations, is also a key factor in supporting continuous improvement in its credit risk profile. Avianca has a weak, unencumbered asset base and a large share of secured debt. Fitch expects it to maintain solid cash balances, with cash/LTM revenue not below 15%-20%, as it seeks to reduce exposure to short-term refinancing risks under its industry high volatility. Avianca's liquidity position is enhanced by an undrawn revolving credit facility of USD200 million due 2027.

Above-Average Industry Risks: The airline industry is inherently a high-risk sector given that it is cyclical and capital-intensive due to various structural challenges, as well as being prone to exogenous shocks. High fixed costs combined with swings in demand and fuel prices typically translate into volatile profitability and cash flows. Exposure to foreign exchange fluctuations for Latin America competitors constitutes an additional risk, as costs are mostly in U.S. dollars and a large part of its cash flows are in local currency. For Avianca, this risk is somewhat mitigated by its international operations.

Consolidated Approach: Fitch applies its "Parent and Subsidiary Rating Linkage Criteria" to Avianca and its 100%-owned subsidiary LifeMiles, following the stronger parent path. The legal incentive for support is high, and the operational and strategic incentives are medium to high, resulting in equalized ratings. LifeMiles is a core asset, generating stable free cash flows and solid EBITDA margins. As of September 2024, LifeMiles contributes around 15% to EBITDA and represents around 7% of Avianca's debt.

Derivation Summary

Avianca's 'B' rating reflects its post-restructuring credit profile, good asset base compared to its regional peers based in terms of fleet, network and route diversification, and its important regional market position. The company's past quarters of continuous improvement of its cost structure and high operating margins are also incorporated into the analysis.

Avianca's rating is below LATAM Airlines Group S.A. (BB-/Positive Outlook) due to relatively higher leverage and weaker business diversification and financial flexibility. Compared to Azul S.A. (CC), Avianca's business and credit profile is stronger, reflecting greater business diversification, stronger capital structure and manageable medium-term refinancing risks. Avianca's limited financial flexibility in terms of an unencumbered asset base and the industry's high risks remain rating constraints.

Key Assumptions

-- Fitch's base case during 2024 and 2025 includes an increase in ASK by 21% and 31%;

-- Load factors around 81% during 2024-2025;

-- Steady cargo operations;

-- Oil prices average USD85/barrel through the forecast;

-- Capex of USD437 million in 2024 and USD550 million in 2025;

-- No dividend distributions.

Recovery Analysis

Key Recovery Rating Assumptions

The recovery analysis assumes Avianca would be considered a going concern in bankruptcy and the company would be reorganized rather than liquidated. Fitch has assumed a 10% administrative claim.

Avianca's going concern EBITDA is USD500 million which incorporates EBITDA post-pandemic, adjusted by lease expenses, plus a discount of 20%. This correlates to an average of USD561 million during 2016-2019, reflecting intense volatility in the airline industry in Latin America. The going-concern EBITDA estimate reflects our view of a sustainable, post-reorganization EBITDA level, upon which we base the valuation of the company. The enterprise value (EV)/EBITDA multiple applied is 5.5x, reflecting Avianca's strong market position in Colombia.

Fitch applies a waterfall analysis to the post-default enterprise valuation based on the relative claims of the debt in the capital structure. The debt waterfall assumptions consider the company's total debt. These assumptions result in a Recovery Rate for the secured debt within the 'RR1' range, but due to the soft cap of Colombia at 'RR4', Avianca's senior secured debt is rated at 'B'/'RR4'.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

-- Liquidity deterioration or difficulty continuing to access credit lines;

-- Gross and net leverage ratios consistently above 5.0x and 4.0x;

-- EBITDA fixed-charge coverage sustained at or below 1.5x;

-- Competitive pressures leading to severe loss in market-share or yield deterioration;

-- Aggressive growth strategy leading to a consolidation movement financed with debt.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

-- Sound business strategy within Avianca's main markets' air traffic, supported by healthy yields and load factors;

-- Successful refinancing of LifeMiles' Term Loan B;

-- Maintenance of a strong liquidity position (cash/LTM revenue consistently above 15%), and a well-spread debt amortization profile with no major refinancing risks in the medium term;

-- Ability to maintain strong cost structure, with adjusted EBITDAR margin above 22% on a sustainable basis;

-- EBITDAR fixed-charge coverage sustained at or above 2.5x;

-- Total and net leverage below 4.3x and 3.5x, on a sustainable basis.

Liquidity and Debt Structure

Avianca maintained a solid liquidity position that is strong for the rating category. As of Sept. 30, 2024, Avianca had around USD1.1 billion in cash and cash equivalents, compared with USD504 million of short-term debt. During the same period, Avianca's total debt was USD5.2 billion, and was mainly composed of USD2.7 billion of leasing obligations, USD1.7 billion of Tranch A1 and A2 (exit-financing) due 2028, LifeMiles' Term Loan B (USD378 million) due 2026, and USD322 million of credit card securitization.

Avianca's cash position of USD1.1 million was sufficient to cover maturities until mid-2026. Avianca's liquidity position is further strengthen by an undrawn revolving credit facility due 2027 in the amount of USD200 million.

Issuer Profile

Avianca is the leading airline in Colombia, Ecuador and Central America, with one of the largest operations in Latin America. As of Sept. 30, 2024, its fleet included 163 aircraft (151 passenger and 12 freighters: 145 Airbus, 18 Boeing). LifeMiles, Avianca's loyalty program, is the top program in Colombia, Ecuador and Central America.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

MACROECONOMIC ASSUMPTIONS AND SECTOR FORECASTS

Click here to access Fitch's latest quarterly Global Corporates Macro and Sector Forecasts data file which aggregates key data points used in our credit analysis. Fitch's macroeconomic forecasts, commodity price assumptions, default rate forecasts, sector key performance indicators and sector-level forecasts are among the data items included.

ESG Considerations

Avianca has an ESG Relevance Score of '4' for Group Structure due to its relatively new and larger airline operational group (ABRA), which has a negative impact on the credit profile, and is relevant to the rating in conjunction with other factors.

Avianca has an ESG Relevance Score of '4' for Governance Structure due to its relatively new operational group (ABRA) that has lately demonstrated aggressive financial policies, which has a negative impact on the credit profile, and is relevant to the rating in conjunction with other factors.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Avianca Midco 2 Limited					
• senior secured	LT	B	Affirmed	RR4	B
Avianca Group International Limited	LT IDR	B	Affirmed		B
	LC LT IDR	B	Affirmed		B
LifeMiles Ltd.	LT IDR	B	Affirmed		B
	LC LT IDR	B	Affirmed		B
• senior secured	LT	B	Affirmed	RR4	B

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

Corporate Rating Criteria (pub.06 Dec 2024) (including rating assumption sensitivity)

Corporate Recovery Ratings and Instrument Ratings Criteria (pub.02 Aug 2024) (including rating assumption sensitivity)

Country-Specific Treatment of Recovery Ratings Criteria (pub.03 Mar 2023)

Parent and Subsidiary Linkage Rating Criteria (pub.16 Jun 2023)

Sector Navigators – Addendum to the Corporate Rating Criteria (pub.06 Dec 2024)

Applicable Models

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

Additional Disclosures

Solicitation Status

Endorsement Status

Avianca Group International Limited	EU Endorsed, UK Endorsed
Avianca Midco 2 Limited	EU Endorsed, UK Endorsed
LifeMiles Ltd.	EU Endorsed, UK Endorsed

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The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. For more details on sector-specific best- and worst-case scenario credit ratings, please see Best- and Worst-Case Measures under the Rating Performance page on Fitch's website.

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