AIRFINANCE GLOBAL

Colombia’s Avianca downgraded again

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Fitch Ratings has downgraded Avianca Holdings’ issuer credit rating to 'B-' from 'B' and its senior unsecured rating to 'CCC+' from 'B-' on concerns about “persistently high leverage ratios, limited financial flexibility and high refinancing risks”.

This is the second ratings downgrade in a month for the Bogota-based carrier, following S&P’s downgrade on 13 May.

The rating agencies are especially concerned about Avianca’s need to refinance its $550 million 8.375% unsecured bonds that mature in May 2020. Because of those risks, Fitch has placed all of Avianca’s ratings on rating watch negative.

Fitch noted that Avianca had $626 million of short-term financial debt but only $357 million of cash (7% of annual revenues) at the end of March.

Avianca’s chief financial officer Roberto Held said last month that the carrier had been working with three banks and hoped to refinance the 2020 bonds in the second quarter.

But the bond refinancing has been held up by the need to amend certain other loan agreements as a result of a recent breach of covenants by BRW Aviation, Avianca’s majority shareholder, under a 2018 loan agreement with United Airlines.

United Airlines’ dramatic intervention at Avianca in late May (a boardroom shakeup, transfer of decision-making powers to minority shareholder Kingsland and a promise of a new $250 million loan) was seen as a positive development that could pave the way for a prompt refinancing of the 2020 bonds.

Fitch acknowledged that those developments could help in Avianca’s refinancing efforts but noted that the “terms and the timing remain uncertain”.

Interestingly, Fitch said that even though it assesses Avianca on a stand-alone basis, with no link to United’s ratings, the presence of United as a strategic partner and the potential new loan are credit positives.

As part of the restructuring, United has offered Avianca a $150 million loan, if needed and requested by the carrier, while Kingsland has committed to providing another $100 million.

According to Fitch, Avianca must amend contracts with several export credit agencies (ECAs) that are creditors on $1.1 billion of its $4 billion total debt (as of December 2018). The changes involve adding United as a permitted holder of Avianca’s shares and removing Synergy Group as a guarantor for the loans.

Another major concern about Avianca is its high leverage. Fitch calculated the year-end 2018 total adjusted debt/EBITDAR at 6.6x, which is down from 7.5x in 2017 but is projected to increase to 6.7x at the end of 2019 due to a “challenging operating environment” in Latin America.

However, Fitch expects the leverage ratio to improve to around 6.3x in 2020, which includes anticipated benefits from the sale of Avianca’s Embraer fleet this year but no additional non-core asset sales.

On the positive side, apart from the 2020 bonds, most of Avianca’s debt is aircraft-related, which the carrier is expected to refinance with new secured loans.

Fitch also notes that Avianca has “some financial flexibility to raise additional cash” from unencumbered aircraft.

Fitch said that Avianca's ratings benefit from its strong regional market position, diversified network, dominant position in Colombia and future joint business agreement (JBA) with United and COPA.

But in part because of intense competition from upstart carriers in its main markets, Avianca's EBIT margins – 6% in 2018 and 5.5-7% projected for 2019 and 2020 – continue to lag behind those of its Latin American peers.

As well as selling its Embraer E190s and many non-core businesses, Avianca is restructuring its route network by shedding unprofitable routes and focusing on its strongest markets.

Fitch considers Avianca's fleet right-sizing to be the key to improving cash flow generation. Last year's $659 million capital expenditures were a major driver for the $248 million negative free cash flow (FCF). Earlier this year Avianca drastically revised its Airbus order commitments, and Fitch now forecasts its FCF to be "neutral to slightly negative" in 2019 and 2020. Capital expenditures are projected to be $441 million in 2019 and $500 million in 2020.

