

Fitch Downgrades Several Latin American Airlines

Fitch Ratings-Chicago-19 May 2020:

Fitch Ratings has downgraded the Foreign Currency Issuer Default Rating (IDR) of LATAM Airlines Group (LATAM), and the Foreign and Local Currency IDRs of Azul S.A. and GOL Linhas Aereas Inteligentes S.A. one or two notches, to 'B-'. All ratings remain on Rating Watch Negative (RWN).

Elevated uncertainty regarding the size and duration of the cash flow burn during the next 12 months were key factors supporting the rating action, as was the deterioration of the financial flexibility enjoyed by these airlines. The coronavirus pandemic has resulted in sharp drops in airline passenger activity due to travel bans, social distancing and sharp economic downturns in the region and throughout Europe and North America.

The downgrades take into account the expectation of a slow recovery period, as well as the sharp deterioration of local currencies and the mismatch between revenues that are primarily generated in local currency and debt and lease obligations that are mostly payable in U.S. dollars or Euros.

Key Rating Drivers

Coronavirus Assumptions: The downgrades reflect increased credit risk for the sector as a result of negative FCF, diminished liquidity positions and weaker balance sheets. The airlines have responded to the challenging environment with capacity reductions ranging from 75%-93%, in domestic markets, up to 95%, in international markets, during the 2Q20. The timing of a recovery remains uncertain as the virus spreads in the region and more restrictive measures are imposed that should stifle demand. Fitch's base case scenario envisions a 55% drop in RPKs (Revenue Passenger Kilometres) for 2020 from 2019 and that 2021 levels will remain 22% below 2019 along with pressured yields. Since mid-March, all issuers have announced, in different terms and magnitude, lease payment and aircraft delivery deferrals, renegotiations with suppliers and significant reduction in personnel expenses.

Extent of Cash Flow Burn Remains Uncertain: The timing and intensity of the cash flow burn during the remainder of 2020 is the key credit concern, as financial flexibility is limited in terms of the issuers' abilities to access new credit lines. During 2Q20, Fitch projects that LATAM's cash flow burn will be about USD600 million and that Azul and GOL will have around BRL800 million and BRL900 million of cash burn. In the case of GOL, this amount does not include any cash inflow from Boeing. Per Fitch's criteria and estimates, readily available cash amounts as of March 31, 2020 were USD1.7 billion for LATAM, BRL1.3 billion for Azul (excludes TAP, SGPS, S.A.'s bonds) and BRL1.8 billion for GOL (excludes cash held at Smiles).

BNDES Support Remains Essential: In terms of government support, so far only Brazil has made a public announcement of financial support through its development bank, BNDES (Banco Nacional de Desenvolvimento Economico e Socia). Negotiations continue and final terms have not been concluded. The

expectation is that there will be a credit line of around BRL2 billion (USD340 million to 400 million) given to each of the three largest airlines operating in the domestic market in Brazil. This cash inflow is a key credit consideration at this point and any major delay or failure to reach an agreement could lead to additional rating actions. In the case of LATAM, the company would be expected to use these funds only for its Brazilian operations, which would limit the liquidity boost provided to the company by BNDES, as the majority of its debt agreements are at the holding company in Chile. LATAM is in discussions with the governments of Chile and Peru.

Derivation Summary

LATAM Airlines Group S.A.

LATAM is well positioned in the 'B' rating category relative to its regional peers given its diversified business model and significant regional market position. The company's financial flexibility has diminished since the coronavirus crisis started and its liquidity position is deteriorating. The company's rating is currently at the same level of Azul S.A and Gol Linhas Aereas Inteligentes S.A., which are also facing cash flow pressure. LATAM is rated lower than global players Delta Air Lines (BB+/Neg), United Continental Holdings, Inc. (BB-/Neg), and American Airlines Group, Inc. (B/Neg). These issuers started the crisis with stronger liquidity positions and have more financial flexibility.

Azul S.A.

Azul's 'B-' rating is at the same level as LATAM and GOL. Azul has a weaker position in the 'B' rating category relative to global peers given its limited geographic diversification and relatively high leverage; nonetheless it has an important regional market position in the Brazilian market that has resulted in higher margins. These positive factors are tempered by the company's ongoing business growth and the high volatility of the Brazilian market. FX risk exposure is viewed as an additional negative credit factor for Azul given its lack of geographic diversification. The company's limited financial flexibility given the impact of the coronavirus on the sector and its deteriorating liquidity position have resulted in a Rating Watch Negative being assigned to its 'B-' ratings.

GOL Linhas Aereas Inteligentes S.A.

GOL's current capital structure compares well with those of the other two main airlines in Latin America rated 'B-' by Fitch: LATAM and Azul. The rating equalization between the three airlines reflects high uncertainty surrounding cash flow burn during 2020 and the speed and degree to which the industry will recover. GOL's ability to adjust its business model and downsize its fleet is positive and could benefit its cost structure and profitability. FX risk exposure is viewed as an additional negative credit factor for GOL given its lack of geographic diversification. Similar to the ratings for Azul and LATAM, the 'B-' rating for GOL along with the Rating Watch Negative reflect limited financial flexibility for the sector and high levels of cash burn during throughout 2020, as well as the high level of uncertainty surrounding the scope of recovery during 2021.

Key Assumptions

Key Assumptions in Fitch's rating case include a steep drop in demand through 2020, with full recovery only occurring by 2022. During 2020 Fitch's base case includes revenues down roughly 90% through the second quarter of the year, down as much as 70% in the third quarter, and down 40% in the fourth quarter for domestic focused carriers and closer to 50% for carriers with more international exposure. Fitch incorporates the company's efforts to reduce variable costs, including salary & wages, marketing expenses, services operations as well as capex reduction and deferral of aircraft deliveries as already announced.

RATING SENSITIVITIES

The resolution of the RWN will depend on the severity of the impact on issuer's operating cash flow generation in 2Q20 and perspectives for the 2H20.

LATAM

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Failure to preserve liquidity and refinance short term financial and leasing obligations;
- Delay and/or failure to obtain government support;
- Prospects of total adjusted debt/EBITDAR sustained above 7.0x and/or net adjusted debt/EBITDAR above 6.0 x by 2021.

AZUL

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Failure to preserve liquidity and refinance short term financial and leasing obligations;
- Delay and/or failure to obtain government support;
- Prospects of total adjusted debt/EBITDAR sustained above 7.0x and/or net adjusted debt/EBITDAR above 6.0x by 2021.

GOL

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Failure to preserve liquidity and refinance short term financial and leasing obligations;
- Delay and/or failure to obtain government support;
- Prospects of total adjusted debt/EBITDAR sustained above 7.0x and/or net adjusted debt/EBITDAR above 6.0x by 2021.

Best/Worst Case Rating Scenario

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

Liquidity and Debt Structure

LATAM Airlines Group S.A.

LATAM held cash of USD1.5 billion as of Dec. 31, 2019, compared with short-term debt of USD1.8 billion and total debt of USD10.4 billion. LATAM had in place a senior secured revolving credit facility (RCF) of USD600 million, which has a combination of aircraft, spare engines and spare parts as collateral. Considering the current scenario of tight liquidity, and seeking to boost its cash position LATAM has fully withdrawn this RCF.

Azul S.A.

Azul held adjusted cash of BRL1.6 billion as of March 31, 2020, per Fitch's calculation, which considers only 40% of its marketable securities relating to the high yields bonds of TAP. At the same period, Azul's total adjusted debt was BRL20.6 billion, with BRL4.3 billion due in the short term (BRL2.4 billion relates to leasing obligations). The company does not have major capital market debt coming due in the next 12 months. Azul does not have a committed standby credit facility.

GOL Linhas Aereas Inteligentes S.A.

As of Dec. 31, 2019, the company had BRL2.6 billion of cash and marketable securities and BRL14.5 billion of total debt. The company's ongoing refinancing strategy over the last few quarters gave an important relief for the company's refinancing risks during 2020. During 2020, GOL faces BRL3.9 billion of maturities with an important capital market debt coming due in August (USD300 million of term loan). GOL's financial flexibility is somewhat limited by having around BRL1 billion of its cash position at its 52.6% subsidiary, Smiles. GOL does not have a committed standby credit facility.

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.

ESG Considerations

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which

they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

AZUL Investments LLP

----senior unsecured; Long Term Rating; Downgrade; B-; RW: Neg

GOL Linhas Aereas Inteligentes S.A.; Long Term Issuer Default Rating; Downgrade; B-; RW: Neg

; Local Currency Long Term Issuer Default Rating; Downgrade; B-; RW: Neg

; National Long Term Rating; Downgrade; BB(bra); RW: Neg

Gol Finance Inc.

----senior unsecured; Long Term Rating; Downgrade; B-; RW: Neg

LATAM Airlines Group S.A.; Long Term Issuer Default Rating; Downgrade; B-; RW: Neg

; National Long Term Rating; Downgrade; BB(cl); RW: Neg

; National Equity Rating; Downgrade; Segunda Clase(cl)

----senior unsecured; National Long Term Rating; Downgrade; BB(cl); RW: Neg

Gol Finance

----senior unsecured; Long Term Rating; Downgrade; B-; RW: Neg

Azul S.A.; Long Term Issuer Default Rating; Downgrade; B-; RW: Neg

; Local Currency Long Term Issuer Default Rating; Downgrade; B-; RW: Neg

; National Long Term Rating; Downgrade; BB(bra); RW: Neg

LATAM Finance Limited

----senior unsecured; Long Term Rating; Downgrade; B-; RW: Neg

GOL Linhas Aereas S.A.; Long Term Issuer Default Rating; Downgrade; B-; RW: Neg

; Local Currency Long Term Issuer Default Rating; Downgrade; B-; RW: Neg

; National Long Term Rating; Downgrade; BB(bra); RW: Neg

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Additional information is available on www.fitchratings.com

Applicable Criteria

[Corporate Rating Criteria \(pub. 01 May 2020\) \(including rating assumption sensitivity\)](#)

[Corporates Notching and Recovery Ratings Criteria \(pub. 14 Oct 2019\) \(including rating assumption sensitivity\)](#)

[Country-Specific Treatment of Recovery Ratings Rating Criteria \(pub. 27 Feb 2020\)](#)

[Equity Rating Criteria in Chile \(pub. 01 Aug 2018\)](#)

[National Scale Ratings Criteria \(pub. 18 Jul 2018\)](#)

[Parent and Subsidiary Rating Linkage \(pub. 27 Sep 2019\)](#)

Applicable Model

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

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 ([1](#))

Additional Disclosures

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