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ASX Market Announcements Office
Australian Securities Exchange
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Fitch Ratings Update

Virgin Australia Holdings (ASX: VAH & VAHHA) provides the attached Fitch Ratings Update for release to the market.

ENDS

This announcement was authorised for release by Virgin Australia Group CEO and Managing Director, Paul Scurrah.

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17 Apr 2020 | Downgrade

Fitch Downgrades Virgin Australia to 'CCC-' on Liquidity Issues

Fitch Ratings-Sydney-17 April 2020:

Fitch Ratings has downgraded Virgin Australia Holdings Limited's (VAH) Long-Term Foreign-Currency Issuer Default Rating (IDR) to 'CCC-' from 'B-' due to the increasing uncertainty around whether the airline will be able to obtain additional financing to ensure it has sufficient liquidity while the coronavirus-related travel restrictions in Australia remain in place. The rating is removed from Rating Watch Negative (RWN), on which it was placed on 26 March 2020.

The rating action follows the company's announcement that it is in discussions on restructuring alternatives. While Fitch believes that the company continues to work on financial assistance, we believe that travel curbs to contain the COVID-19 pandemic are increasingly straining its liquidity such that default is a real possibility.

VAH's working capital is increasingly being affected by cancellations, minimal bookings and outflows at its loyalty programme as members redeem points for non-flight benefits. The airline has now grounded most of its fleet to minimise cash outflows, but it is seeking options to shore up its liquidity. VAH's ability to secure this funding is important to maintain its viability.

Fitch believes the measures VAH took to ground its entire domestic fleet and run only the government-subsidised minimum domestic network will help the airline preserve cash flows. However, we believe the airline will run out of liquidity over the next six months without fresh third-party support. It remains uncertain when the travel restrictions will be lifted, and the time it will take for consumers to return to travel and VAH's operations to return to normal.

Key Rating Drivers

COVID-19-Related Impact: Liquidity stress has been amplified as all non-essential travel between cities in Australia is effectively prohibited. VAH has suspended international operations and all domestic flights, except for the government-subsidised minimum domestic network. We expect cash-flow generation to fall significantly in the financial year ending June 2020 (FY20), and continue into at least 1HFY21. As a result, we believe that VAH will require fresh third-party financial support to ensure its survival during the travel restrictions and the aftermath once they are lifted.

Liquidity Pressure & Restructuring: VAH says that it remains in discussions on financial assistance. Fitch believes debt restructuring is a possibility unless VAH is able to obtain additional funding or some form of financial assistance from the government or another party. Fitch expects VAH to experience significant working-capital outflows for the remainder of FY20 as customers seek refunds and bookings fall sharply, and there are outflows for aircraft rent, staff costs, frequent-flyer point redemptions and other charges.

In our view, without additional funding over the next few months, there is a high chance that the airline will not be able to survive the impact of the COVID-19 shut down. We believe the government's relief package announced in March 2020, which provides refunds of airport charges incurred since February 2020, provides little support past FY20 given the grounding of most of VAH's fleet. Further, the government's announcement that it will subsidise a minimum domestic network from April to June 2020 will also provide little liquidity relief for the airline above what it could save with the grounding of its fleet.

Coronavirus Assumptions: Fitch now forecasts VAH's domestic capacity to fall by 100% for the rest of FY20, before recovering gradually from August 2020. We believe the government subsidies for flights will be, on the whole, earnings neutral and have not incorporated their effect into our forecast. We assume VAH's revenue passenger kilometres (RPK) and available seat kilometres (ASK) to gradually recover to close to our previous estimates by FY22. We believe that the coronavirus-related curbs in Australia will continue to have a strong impact on travel throughout FY21, although domestic travel may slowly resume over the next couple of months.

VAH's earliest debt maturity is USD350 million in October 2021, however the company is unlikely to be in a position to meet its debt service requirements beyond September 2020 without additional funding.

Limited Levers, but Lasting Impact: VAH has options available that we have not specifically incorporated into our short-term liquidity forecasts, including handing back leased aircraft and selling or borrowing against owned aircraft. We believe these measures, which would have a lasting impact and affect VAH's ability to recover, would be VAH's last line of defence. In addition, we have not included any potential further relief from the government to the aviation sector in our forecasts.

Derivation Summary

VAH's rating reflects the liquidity pressures it is facing compared with peer, Public Joint Stock Company Aeroflot - Russian Airlines (Aeroflot, BB/Negative). Aeroflot benefits from its position as Russia's flagship carrier, as well as the diversification of its route network, favourable hub position and competitive cost structure. Aside from the liquidity pressures, VAH's business profile is comparable with that of Aeroflot as well. VAH has a strong market position as a result of the structure of the Australian aviation market and protection from Australia being the final destination for most travellers.

The main factors underscoring the seven-notch differential are the two-notch uplift for Aeroflot's rating under Fitch's Government-Related Entities Rating Criteria, with the remaining notches attributable to Aeroflot's better business profile due to larger scale and the deterioration of VAH's financial profile - which has led to three-notch downgrade - as it responds to the pandemic.

Latin American peers, GOL Linhas Aereas Inteligentes S.A. (B/RWN) and LATAM Airlines Group S.A. (B+/RWN) have also been downgraded to account for strong cash-flow burn associated with the pandemic. The rating differential with VAH's reflects the relative stronger liquidity position of these peers.

Key Assumptions

Fitch's Key Assumptions Within Our Rating Case for the Issuer

- COVID-19-Related Assumptions: Domestic ASK to reduce by over 90% in 4QFY20. ASK capacity cuts to reduce during 1HFY21, with load factors and prices to recover towards FY19 levels by FY22. Domestic ASK to reflect FY19 levels in FY22

- International ASK to reduce by 100% in 4QFYE20. ASK capacity to gradually recover from December 2020, but overall ASK to remain below historical levels. Load factors and prices to recover to FY19 levels from FY22.

- Associated cost savings from grounding of aircraft to be achieved, with aircraft returning to service in 1HFY21 in line with ASK reinstatements.

- Group capacity to expand by low single digits in FY23 across all group airlines, with group-wide load factors to improve to around 82.5% by FY23.

- Velocity revenue to fall by 60% in FY21 and increase to historical levels from FY22.

- Jet fuel requirements to move in line with changes in ASK. Prices are based on Gulf Coast Jet Fuel Platts swap prices from September 2019 to February 2023.

- VAH to realise guided annual AUD75 million in employee cost savings and other supplier savings by FYE21.

- Capex of AUD400 million in FY20, AUD326 million in FY21, AUD367 million in FY22 and AUD367 million in FY23.

RATING SENSITIVITIES

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

- VAH is able to obtain additional liquidity to support working capital and enacts a definitive refinancing plan to address its October 2021 debt maturity.

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

- VAH is unable to obtain additional liquidity support.

- There is an increased likelihood of default, which could stem from a debt restructuring.

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

Liquidity Pressures: Fitch expects VAH's free cash flow to be negative in FY20 and FY21 and put liquidity under pressure as it responds to the COVID-19-related disruption. We believe that actions taken so far to reduce cash outflows, in particular the prompt grounding of fleet, has given VAH time to manage through the situation. However, we now believe that VAH needs to secure additional funding in the coming months to ensure its ongoing viability.

The airline's next significant debt maturity is a USD350 million facility in October 2021. The airline has aeronautical finance facilities in place, but VAH has limited unencumbered assets against which it can raise further secured debt to shore up liquidity.

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
ESG issues are credit neutral or have only a minimal credit impact on the entity(ies), either due to their nature or 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.

Virgin Australia Holdings Limited; Long Term Issuer Default Rating; Downgrade; CCC-

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Additional information is available on www.fitchratings.com

Applicable Criteria

Corporate Rating Criteria (pub. 27 Mar 2020) (including rating assumption sensitivity)
Corporates Notching and Recovery Ratings Criteria (pub. 14 Oct 2019) (including rating assumption sensitivity)
Parent and Subsidiary Rating Linkage (pub. 27 Sep 2019)
Sector Navigators-Addendum to the Corporate Rating Criteria (pub. 27 Mar 2020)

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

Dodd-Frank Rating Information Disclosure Form
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