BCP Research: LATAM (LTMCI -/-/C)- Approval of Revised DIP Proposal- Upgrade LTMCI 24s to 'Positive'

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Summary: A revised shareholder sponsored DIP proposal was approved under LATAM Airlines' Chapter 11 process. Tranche A amendments allow for the Jefferies syndicate to contribute US$125 mm of the US$1.3 bn commitment, reducing Oaktree Capital's contribution to US$1.125 bn. Most notable, however, are the amendments to Tranche C eliminating the conversion feature. Tranche C totals US$1.15 bn, US$750 mm of which will be funded by key prior shareholders, and US$250 of which will be funded by the Jefferies syndicate. The remaining US$150 mm may be made available to existing creditors, shareholders and/or new investors - at the company's discretion. The current structure postpones the dilutive event (future capital raise or DIP conversion) to meet the DIP maturity. Should a conversion feature be introduced to Tranche C as part of an approved reorganization plan, the Jefferies syndicate's will have the right to opt to participate or receive cash. If the conversion feature is not reinstated, the entire DIP will need to be repaid through a future capital raise.

	Company Name	Amt (US$ MM)	Ratings (M/SP/F)	Mid Indicative Price	Rank
LTMCI 6.875% 04/11/24	Latam Finance Ltd	700	-/ -/ C	38.5	Sr. Unsecured
LTMCI 7% 03/11/26	Latam Finance Ltd	800	-/ -/ C	38.5	Sr. Unsecured

**Indicative prices as of 9/25/20*

As we've stated in the past, LATAM's Chapter 11 filing was driven primarily by fleet management. The company has continued to generate cash through 2Q20, what was arguably the peak of the impact of the COVID-19 crisis. We anticipate LATAM and others will exit the crisis by attempting to implement a Low Cost Carrier (LCC) business model, with a smaller, more uniform fleet and reduced cost structure. The Chapter 11 process streamlines fleet reduction, permitting abandonment of owned aircraft and rejection of leased aircraft which, together with power-by-the-hour leases and higher discount rates, will cut fleet debt. Meanwhile, the strength of the Ad Hoc committee continues to be a key positive for LATAM unsecured creditors.

Given the direction of the process, it appears likely bondholders will retain a seat at the table in determining the form of the capital raise or DIP conversion. While projections have not been disclosed, industry consensus estimates imply 2022/23 revenue and EBITDA will still be 20% below 2019 levels, implying ~US$7.3 bn in revenues and ~US$1.6 bn in EBITDA for our base case "recovered" profitability scenario. We expect operating leases will be rejected, and overall fleet financing reduced to US$5.7 bn, with 15% of operating leases added to the unsecured claim pool, alongside other unsecured debt. Including the revised US$2.5 bn DIP, this would bring pro-forma total debt to US$8.2 bn with all unsecured claims converted to equity. Allowing for US$1.0 bn cash burn, cash would be US$2.5 bn, meeting our 30% cash to revenue threshold, but leaving net debt elevated. We estimate US$1.5 bn in new money will be needed, either through a capital raise or DIP conversion to bring net leverage below 3x. Assuming a capital raise led by unsecured creditors would mean ~50c in new money relative to existing par claims for a total cost basis of ~90c using todays 39c mid mark on the bonds. If market cap traded to 5x our base case EBITDA, we see 120c recovery on a 90c investment. LATAM historically enjoyed higher multiples. A 7x TEV would imply 230c recovery. Were LATAM to achieve margin improvement projected by peers Avianca and AERMEX by pursuing the LCC model, recoveries could be substantially higher. Inevitably, those who do not provide new money will suffer much higher dilution, capping upside. Given the more equitable direction of the process and reasonable upside based on conservative projections, we upgrade LTMCI 6.875% 24s to 'Positive' on our High Octane list, recognizing many risks remain, including the terms of additional funding.

US MM	2019	BCP Base Case	BCP Upside Case
ASKs	149.1	104.4	104.4
RPKs	124.5	83.5	83.5
LF	83.5%	80.0%	80.0%
PAX (mm)	58.1	40.7	40.7
Revenue	**10,431**	**7,302**	**8,345**
EBITDAR	**2,223**	**1,556**	**2,337**
Margin	*21%*	*21%*	*28%*
A/R	1,244	871	995
% revenue	*12%*	*12%*	*12%*
Inventory	354	248	283
A/P	(2,223)	(1,556)	(1,778)
Net WK	**(624)**	**(437)**	**(499)**
% revenue	*(6%)*	*(6%)*	*(6%)*
Cash	**1,073**	**2,190**	**2,503**
% revenue	*10%*	*30%*	*30%*

Debt (US MM)	2019	BCP Base Case	BCP Upside Case
Fleet Financing	**8,363**	**5,702**	**5,702**
Aircraft Debt	5,702	-	-
Operating Leases	2,661	5,702	5,702
Unsecured debt	**2,662**		
DIP		**2,200**	**2,450**
A		1,300	1,300
B		-	-
C		900	1,150
Total Debt	11,025	7,902	8,152
Net Debt	**9,952**	**5,712**	**5,649**
Gross Leverage	5.0x	5.1x	3.5x
Net Leverage	**4.5x**	**3.7x**	**2.4x**
Unsecured Claims		**3,062**	**3,062**
Bonds and other		2,662	2,662
Op. Lease Deficiencies		400	400
Secured Debt Deficiencies		-	-
Price		39%	39%
Market Value		**1,179**	**1,179**
Capital Raise		**1,500**	**1,500**
% unsecured claims		49%	49%
Total Cost Basis		**2,679**	**2,679**
% par		87%	87%
Net Debt		**4,212**	**4,149**
Net Leverage		**2.7x**	**1.8x**

Base Case:

TEV Multiple	TEV	Market Cap	Recovery	Cost Basis
5.0x	7,781	3,319	124%	1.4x
6.0x	9,337	4,876	182%	2.1x
7.0x	10,893	6,432	240%	2.7x

Upside Case–EBITDA Similar to AERMEX/Avianca:

TEV Multiple	TEV	Market Cap	Recovery	Cost Basis
5.0x	11,683	7,534	281%	3.2x
6.0x	14,019	9,871	368%	4.2x
7.0x	16,356	12,207	456%	5.2x

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Top Picks Universe
"Market Outperform" – The bond's total return is expected to exceed the total return of the J.P. Morgan Corporate Emerging Markets Bond Index series ("CEMBI") Broad Diversified High-Yield Index over the next 3 – 6 months.

"Market Perform" – The bond's total return is expected to be in line with the total return of the CEMBI Broad Diversified High-Yield Index over the next 3 – 6 months.

"Market Underperform" – The bond's total return is expected to be below the total return of the CEMBI Broad Diversified High-Yield Index over the next 3 – 6 months.

"Not Rated" or no comment – Currently, the analyst does not have adequate conviction about the bond's total return relative to the CEMBI Broad Diversified High-Yield Index over the next 3 – 6 months.

Quasi Sovereign Universe
"Market Overweight" – The spread of the bond to its similarly duration sovereign controller bond is expected to decrease over the next 3 – 6 months.

"Market Weight" – The spread of the bond to its similarly duration sovereign controller bond is expected to remain unchanged over the next 3 – 6 months.

"Market Underweight" – The spread of the bond to its similarly duration sovereign controller bond is expected to increase over the next 3 – 6 months.

"Not Rated" or no comment – Currently, the analyst does not have adequate conviction about the bond's spread to its similarly duration sovereign controller bond over the next 3 – 6 months.

High Octane Universe
"Speculative Buy" – Bonds that in our view have an equity investment risk profile and we think risk/return is significantly skewed to the upside

"Positive" – Bonds that in our view have an equity investment risk profile and we think risk/return is skewed to the upside

"Neutral" – Bonds that in our view have an equity investment risk profile and we think risk/return is balanced

"Negative" – Bonds that in our view have an equity investment risk profile and we think risk/return is skewed to the downside

"Speculative Sell" – Bonds that in our view have an equity investment risk profile and we think risk/return is significantly skewed to the downside

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