FitchRatings

25 MAR 2025

Fitch Rates Azul's Superpriority Secured Notes 'CCC'/'RR4'

Fitch Ratings - Rio de Janeiro - 25 Mar 2025: Fitch Ratings has assigned a rating of 'CCC' with a Recovery Rating of 'RR4' to Azul Secured Finance LLP's USD525 million superpriority secured notes due 2030.

Fitch currently rates Azul S.A., the guarantor of the notes, with Long-Term Foreign and Local Currency Issuer Default Rating (IDRs) of 'CCC' and a Positive Rating Outlook. The Positive Outlook reflects expectations of Azul's credit profile strengthening in the short to medium term due to cash flow improvements and potential liquidity events from its restructuring plan. High leverage, limited financial flexibility and industry risks remain rating constraints.

Key Rating Drivers

Debt Agreement Qualified as DDE: On Jan. 28, 2025, Azul announced the conclusion of its broad refinancing agreement involving its main creditors and suppliers, including the exchange offer for its existing 2029 and 2030 notes. The total amount reached around BRL5.4 billion, out of a total debt of BRL30.7 billion as of Sept. 30, 2024.

Per its criteria, Fitch views this as a distressed debt exchange (DDE). The deal was assessed to avoid default. Despite no immediate debt haircut or maturity extension, bondholders who did not accept the deal faced worse terms due to the larger secured debt profile and lower returns from the equitization of part of the 2029 and 2030 notes. Azul also announced the completion of a USD525 million superpriority notes issuance, a precedent condition for the restructuring deal.

Lessors and OEM Agreement: Azul reached commercial agreements with lessors and OEMs totaling approximately USD557 million in exchange for 96 million new AZUL4 preferred shares in a one-time issuance to be completed in the first quarter of 2025. The process involves extinguishing USD244 million of existing notes held by certain lessors and OEMs and exchanging the remaining 2030 lessor/OEM notes for new unsecured notes due in 2032, with an option to pay interest in kind.

These agreements included a financing condition tied to ongoing negotiations with bondholders and the ability to raise new debt. According to Azul, this agreement will improve cash flow by approximately USD300 million over 2025, 2026 and 2027.

Agreement with Bondholders: Azul secured the current USD525 million superpriority funding agreement with bondholders, including USD150 million provided in November 2024 that has been fully paid. This involved equitizing USD785 million of new 2029 and 2030 notes into preferred shares: 35.0% of the new exchange notes by April 30, 2025, and 12.5% upon completing an equity offering raising at least USD200 million. The remaining 52.5% will be exchanged by April 30, 2025, into new exchangeable notes with 4.0% cash interest plus 6.0% payment in kind.

Successful Restructuring to Improve Liquidity: Besides the new USD525 million issuance, Azul is looking for an opportunity to raise additional cash from a potential follow-on equity issuance and other sources of liquidity, including ABGF (Agencia Brasileira Gestora de Fundos Garantidores e Garantias). Fitch believes these events still carry execution risk as they depend on market conditions and are not entirely within management's control and cannot assume this as its base case scenario. Azul's ability to enhance its liquidity and manage refinancing risks in the short to medium term could further benefit its ratings.

Cash Flow Burn: Azul faced multiple challenges such as BRL devaluation, an approximate 10% revenue loss due to Rio Grande do Sul flooding, and delays in receiving new aircraft, all of which pressured its operating cash flow generation during 2024. These factors, along with high interest, rental payments and capital expenditures, result in recurring negative free cash flow. EBITDA generation reached around BRL6 billion in 2024, and Fitch expects it to move closer to BRL7.2 billion in 2025. Lease rental, interest, and capex are projected to total BRL8 billion in 2025.

Effective Deleveraging Expected Late 2025: Azul's leverage is expected to peak in 2024 and decline through 2025, reaching 4.5x by 2026, according to Fitch's estimates. Improvements in EBITDA generation are expected to restore its credit profile in the medium term. Fitch's base case forecasts total and net adjusted leverage/EBITDAR ratios of 6.2x and 6.0x, respectively, in 2024, decreasing to 5.0x and 4.7x, respectively, in 2025 and 4.7x and 4.5x, respectively, in 2026. Fitch calculates Azul's total debt at BRL37 billion by year-end Dec. 31, 2024.

Potential Merger with GOL: The current rating scenarios do not incorporate any consolidation movement. Azul has been vocal about its strategy to consolidate the market and is considering a potential transaction with GOL Linhas Aereas Inteligentes S.A. (currently undergoing Chapter 11 proceedings in the U.S.). The final terms of the deal and the pro forma capital structure of the combined entity remain unclear. Once information is available Fitch will reassess the impact on Azul's ratings post-merger.

Peer Analysis

Azul has a weaker position relative to global peers given its limited geographic diversification, higher operating leverage and weaker financial flexibility. In terms of regional peers, it has a weaker position than LATAM Airlines Group S.A.(BB-/Positive) and Avianca Group International Limited (B/Stable) in business diversification, liquidity and financial flexibility. In contrast to LATAM and Avianca, Azul has not completed a debt haircut as part of its post-pandemic restructuring.

Azul's strong position in the Brazilian regional market and high operating margins have been major rating drivers. FX risk is a negative credit factor, considering its limited geographic diversification. The company employs currency hedging, which only partially mitigates this risk.

Fitch expects LATAM and Avianca to maintain gross leverage of about 2.5x and 3.5x, respectively, in the next two years, while Azul's credit metrics should be around 4.5x in 2024. Azul's leasing and interest burden and capex program significantly increase the risks associated with funding its sizable negative FCF.

Key Assumptions

--Fitch's base case during 2025 and 2026 includes an increase in ASK by 6% and 11%, respectively, and in RPK of 6% and 10%, respectively;

--Load factors around 80%-81% during 2025 and 2026;

--Adjusted EBITDAR margins of around 30%-32% in 2025 and 2026;

--Capex of BRL1.4 billion in 2025 and BRL2.0 billion in 2026.

Recovery Analysis

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

Going Concern Approach

Azul's going concern EBITDA is BRL2.5 billion, which incorporates the low-end expectations of Azul's EBITDA post-pandemic, adjusted by lease expenses, and a discount of 20%. The going concern EBITDA estimate reflects our view of a sustainable, post-reorganization EBITDA level on which Fitch bases the valuation of the company. The enterprise value (EV)/EBITDA multiple applied is 5.5x, reflecting Azul's strong market position in Brazil.

Fitch applies a waterfall analysis to the post-default EV, based on the relative claims of the debt in the capital structure. The debt waterfall assumptions consider the company's total debt as of Dec. 31, 2024. These assumptions result in a recovery rate for the first-lien and superpriority secured bonds within the 'RR1' range and second-lien secured notes within the 'RR2' range. However, due to the soft cap of Brazil at 'RR4', Azul's senior secured notes are rated at 'CCC'/'RR4'. For the unsecured notes, the recovery is in the 'RR6' range, resulting in a rating of 'CC'/'RR6'.

RATING SENSITIVITIES

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

--Liquidity deterioration and/or difficulties in continuing to access credit lines;

--Gross and net leverage ratios consistently above 6.5x and 6.0x, respectively;

--EBITDA fixed-charge coverage sustained at or below 1x;

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

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

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

--Improved liquidity position and maintenance of a well-spread debt amortization profile with no major refinancing risks in the medium term;

--EBITDAR fixed-charge coverage sustained at or above 1.1x;

--FCF generation above Fitch's base case expectations;

--Gross and net leverage consistently below 5.5x and 5.0x, respectively;

--Continued solid rebound of Brazilian domestic air traffic.

Liquidity and Debt Structure

Azul's short-term maturities totaled BRL8.5 billion (BRL2.2 billion of financial debt and BRL6.3 billion of leasing obligations) as of Dec. 31, 2024. Azul's readily available cash, per Fitch's criteria, declined to BRL1.3 billion from BRL1.9 billion at the end of December 2023. According to Fitch's estimates, Azul would not be able to generate enough cash flow and lacks sufficient liquidity to fulfill those obligations without new money.

Total debt was BRL31.2 billion, and primarily consists of BRL17.3 billion of leasing obligations, BRL977 million of the bridge notes due 2025, BRL196 million of cross-border senior unsecured notes due 2026, and BRL11.4 billion of secured issuances due 2028, 2029 and 2030.

Issuer Profile

Azul is one of Brazil's largest airlines, dominating the regional market and serving as the sole carrier on 82% of its routes. In 2024, 93% of its revenues came from passengers, while 7% came from cargo and other sources.

Date of Relevant Committee

31 January 2025

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

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
Azul Secured Finance LLP					
• super LT		CCC	New Rating	RR4	

ENTITY/DEBT	RATING	RECOVERY	PRIOR
senior			

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)

National Scale Rating Criteria (pub.22 Dec 2020)

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

Azul Secured Finance LLP	EU Endorsed, UK Endorsed

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