

24 SEP 2024

Fitch Downgrades Azul's Ratings to 'CCC'

Fitch Ratings - Rio de Janeiro - 24 Sep 2024: Fitch Ratings has downgraded Azul S.A.'s Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) to 'CCC' from 'B-', and its National Scale Rating to 'CCC(bra)' from 'BB(bra)'. Fitch has also downgraded Azul Secured Finance LLP's senior secured notes to 'CCC'/RR4' from 'B-'/RR4' and Azul Investments LLP's unsecured notes to 'CC'/RR6' from 'CCC+'/RR5'.

The downgrades reflect Azul's heightened refinancing risk and weaker cash flow profile challenged by the depreciation of the Brazilian real (BRL). Fitch believes the likelihood that company will be able to raise the necessary financing to materially improve its capital structure and/or its cash flow profile at this time has been reduced, reflecting a credit risk more commensurate with a 'CCC' rating.

Reaching a solution is getting longer than Fitch initially expected and less friendly in terms of collateral package and financial costs, which further leads to an unsustainable capital structure. Azul has informed its ongoing renegotiations with lessors are evolving, and that, the terms involve, among others, a potential replacement debt for equity interest in Azul.

Key Rating Drivers

Cash Flow Burn Accelerating: Negative headwinds faced by Azul relate to BRL devaluation, around 10% revenue loss within its operations in Rio Grande do Sul, and delayed on receiving new aircraft is pressuring its operating cash flow generation during 2024. This combined with Azul's high interest and rental payments and capex results in negative free cash flow generation. EBITDA for the second half of the year is estimated around BRL3.3- BRL3.6 billion and lease rental, interests and capex should sum up BRL4.1 billion, per Fitch estimative.

Heightened Refinancing Risks: Fitch believes the likelihood that Azul will be able to raise the necessary financing to fund its cash flow burn, short term financial debt maturities and to recompose its lease obligations at sustainable conditions has been reduced since the last review. As of June 30, 2024, Azul had BRL1.5 billion of debt in the short term, with BRL1.2 billion being due during 2H24, and around BRL1.4 billion of readily available cash, per Fitch's criteria.

As per Fitch's estimates, the company will not be able to generate enough cash flow nor has sufficient liquidity to fulfil those obligations, without new money. The margin of safety to avoid a Fitch defined default-like process has diminished given the pressure on cash flow and still ongoing renegotiations, which is commensurate with the 'CCC' rating category.

Recovery Analysis

KEY RECOVERY RATING ASSUMPTIONS

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, plus a discount of 20%. The going-concern EBITDA estimate reflects Fitch's view of a sustainable, post-reorganization EBITDA level, upon 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 the 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 June 30, 2024. These assumptions result in a recovery rate for the first-lien secured bonds within the 'RR1' range, but due to the soft cap of Brazil, this is kept at 'RR4', and second-lien secured notes fall within 'RR4' range. Azul's senior secured are rated at 'CCC'/RR4'. For the unsecured notes, the recovery is within the RR6 range, therefore results in two notches downgrade from the IDR, being rated at 'CC'/RR6'

RATING SENSITIVITIES

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

--An upgrade of Azul's ratings is unlikely until the company addresses its short-term refinancing needs and liquidity concerns.

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

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

--Announcement of debt restructuring or refinancing with weaker terms to creditors

--A downgrade could occur if Fitch believes that a default or default-like process appears probable or has begun.

Liquidity and Debt Structure

High Refinancing Risks: Azul's short-term maturities totaled BRL6.0 billion (BRL1.5 billion of financial debt and BRL4.5 billion of leasing obligations) as of June 30, 2024. Azul's readily available cash, per Fitch's criteria, declined to BRL1.5 billion from BRL1.9 billion at end of December 2023. Total long-term debt was BRL31.5 billion, and primarily consists of BRL14.3 billion of leasing obligations, BRL382 million of cross-border senior unsecured notes due 2024, BRL176 million due 2026, and BRL9.9 billion of secured issuances due 2028, 2029 and 2030, BRL2.1 billion of other loans and financing, BRL3.6 billion of lessors equity/note and BRL1 billion of convertible debentures.

Issuer Profile

Azul is one of Brazil's largest local airlines, with significant presence in the regional market and being the sole player on 82% of its routes. During 2023, 93% of its revenues were derived from passengers and 7% from cargo and others.

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 Investments LLP				
• senior unsecured ^{LT}	CC	Downgrade	RR6	CCC+
Azul S.A.	LT IDR	CCC	Downgrade	B-
	LC LT IDR	CCC	Downgrade	B-
	Natl LT	CCC(bra)	Downgrade	BB(bra)
Azul Secured Finance LLP				
• senior secured ^{LT}	CCC	Downgrade	RR4	B-
• Senior Secured 2nd Lien ^{LT}	CCC	Downgrade	RR4	B-

RATINGS KEY OUTLOOK WATCH

POSITIVE

NEGATIVE

RATINGS KEY OUTLOOK WATCH

EVOLVING	◊	◆
STABLE	○	

Applicable Criteria

[Corporate Rating Criteria \(pub.03 Nov 2023\) \(including rating assumption sensitivity\)](#)

[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 \(pub.21 Jun 2024\)](#)

Additional Disclosures

[Solicitation Status](#)

Endorsement Status

AZUL Investments LLP EU Endorsed, UK Endorsed

Azul S.A. EU Endorsed, UK Endorsed

Azul Secured Finance LLP EU Endorsed, UK Endorsed

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central repository in accordance with Articles 11(2) of Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 and The Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019 respectively.

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direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. For more details on sector-specific best- and worst-case scenario credit ratings, please see [Best- and Worst-Case Measures](#) under the Rating Performance page on Fitch's website.

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