

07 JUN 2021

## Fitch Assigns Positive Outlook to Azul; Affirms IDRs at 'CCC+'

Fitch Ratings - Rio de Janeiro - 07 Jun 2021: Fitch Ratings has affirmed Azul S.A.'s (Azul) Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) at 'CCC+' as well as the 'CCC+'/'RR4' rating of the senior unsecured notes due in 2024 that were issued by Azul Investments LLP. Fitch has upgraded Azul's Long-Term National Scale rating to 'B' (bra) from 'CCC(bra)'. Fitch has assigned Positive Rating Outlooks to Azul's international and national scale ratings.

Fitch has also assigned a 'CCC+'/'RR4' rating to the USD300 million-USD500 million range of five to seven years unsecured notes to be issued by Azul Investments, which will be fully guaranteed by Azul and its subsidiary Azul Linhas Aereas Brasileiras S.A. The use of the proceeds is for general corporate purposes.

The Positive Outlooks reflect Azul's improved liquidity position and financial flexibility over the last few quarters. It also incorporates Azul's strong domestic business position and network that should benefit from a rebound in domestic air traffic during the second half of 2021 as the vaccination plan is rolled-out in Brazil.

### Key Rating Drivers

**Strong Domestic Market Position:** Azul's credit profile benefits from its unique regional airline market position in Brazil, with a strong presence in underserved markets and limited route overlap with competitors, GOL and LATAM. Azul is the sole provider of services on 77% of its routes and is one of the two largest airline companies in Brazil with a market share of around 31% as measured by revenues/passenger/kilometer in 2020. As Brazil is the company's key market, Azul's operating results are highly correlated to the Brazilian economy.

**Brazilian Vaccination Program:** Experiences around the world indicate a strong correlation between vaccination levels and a rebound of domestic air travel. Azul is uniquely positioned as a leading domestic airline to benefit from a return to more normal travel activity during the next 12 to 24 months, as reflected by the Positive Outlook. Around 49 million people or 23% of the Brazilian population have received the first dose of the vaccine and around 23 million, or only 11% of the population, have received the second dose.

**Improved Financial Flexibility:** Azul has improved its liquidity position over the past few quarters. The company continues to have access to credit market and has benefitted from the financial flexibility provided by its suppliers. Azul' strong cash position should help it withstand short-term volatility if a

third wave of COVID-19 cases occurs during the vaccine rollout.

Rebound in Mid-2022: Fitch's current base case for the Brazilian domestic airline industry assumes a recovery that will only reach 2019 levels of traffic by mid-2022. Given its unique network, as well as its more aggressive growth strategy, Azul has outperformed the overall market. Fitch expects Azul's RPKs to be 15% below pre-Covid 2019 figures during 2021. This compares with 2020 levels that were 40% below those of 2019. Industry dynamics should remain unchanged in the short to medium term, with leisure passengers representing a higher proportion of the mix, which should limit a more substantial recovery in yields.

Cash Flow Pressure: Azul has made important advances in cost initiatives and on the renegotiation with suppliers, but the slow pace of air traffic recovery and BRL1.5 billion of capex will result in negative FCF of BRL1.9 billion in 2021. These figures compare with BRL453 million of capex in 2020 and BRL310 million of negative FCF. The company's financial flexibility has been aided by agreements of payment schedules with lessors that has provided working capital relief of around BRL3.2 billion through 2021. The lower monthly lease rates will be compensated for by slightly higher rates starting in 2023 or by the extension of certain lease agreements at market rates.

Growth Strategy to Watch: Azul has shown an aggressive growth strategy over the past years in terms of organic growth and has recently stated its interests in further consolidating the local domestic market. The company has declared its interest in merger/association with the operations of Latam Airlines in Brazil, and is in talks with creditors. The Chilean company, which is still under its Chapter 11 Process in the U.S., has declared no interest in the deal.

## Derivation Summary

Azul's Positive Outlook reflects Fitch's expectation that the company is uniquely positioned to benefit from a recovery of domestic air travel demand. The 'CCC+' rating, however, reflects the continuation of a high degree of uncertainty as to the timing and scope of the recovery. Azul's liquidity position is positive and compares well with its most similarly rated peer, GOL Linhas Aereas Inteligentes S.A (CCC+). Azul's has higher operating leverage compared to GOL.

Azul has a weaker position relative to global peers given its limited geographic diversification and relatively high operating leverage; nonetheless, its strong position in the Brazilian regional market, high operating margins and a track record of strong liquidity ratios have been key rating drivers. These positive factors are tempered by the company's ongoing business growth and operational volatility related to its key market, Brazil. FX risk exposure is a negative credit factor for Azul considering its limited geographic diversification; the company has implemented a currency hedge position that partially mitigates this risk.

## Key Assumptions

--During 2021, Fitch's base case includes a decrease in RPK by 15%, with a full rebound to 2019 levels

occurring by 2022.

--Load factors around 80% during 2021 and 2022;

--Capex of BRL1.5 billion per year for 2021 and 2022.

## **RATING SENSITIVITIES**

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Solid rebound domestic air traffic in Brazil;

--Material improvement in the company's liquidity position and debt amortization profile;

--Net leverage ratios below 4.5x by 2022.

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

- -Deterioration in Azul's liquidity profile or difficulties to continue to access credit lines;

--Slowdown in the pace of the rollout of vaccines in Brazil.

## **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**

Good Cash Position: Azul held readily available cash of BRL2.3 billion as of March 31, 2021, per Fitch's calculation. This compares with BRL3.5 billion of short-term debt, including BRL3.0 billion of leasing obligations. In the same period, Azul's total debt was BRL21.9 billion. This primarily consists of BRL14.1 billion of leasing obligations, BRL2.5 billion of convertible debentures, BRL2.5 billion cross-border senior notes, BRL1.3 billion of aircraft and engine loans and BRL701 million in local debentures as of June 30, 2020.

Azul does not have a committed standby credit facility, but it has the option to issue an additional BRL500 million of debt related to its convertible debentures. Giving the ongoing market volatilities,

Azul's continuous ability to access credit/debt markets during 2021 and 2022 is key to maintain healthy cash levels. Azul consider its liquidity position is further enhanced by BRL1.0 billion in account receivables, BRL1.8 billion in security deposits and maintenance reserves, and BRL1.1 billion in long-term receivables.

## **Issuer Profile**

Azul is one of the largest local airlines in Brazil. It has an important presence in the regional market and is the sole airline on 77% of its routes. As of Dec. 31, 2020, 18% and 8% of its domestic network overlapped with GOL and LATAM, respectively. Azul's market share was 31% during 2020.

## **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**

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This 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. For more information on Fitch's ESG Relevance Scores, visit [www.fitchratings.com/esg](http://www.fitchratings.com/esg)

## **Fitch Ratings Analysts**

### **Debora Jalles**

Director

Primary Rating Analyst

+55 21 4503 2621

Fitch Ratings Brasil Ltda. Av. Barão de Tefé, 27 – Sala 601 Saúde Rio de Janeiro, RJ 20220-460

### **Francisco Mercadal**

Associate Director

Secondary Rating Analyst

+56 2 2499 3340

### **Joe Bormann, CFA**

Managing Director

Committee Chairperson



+1 312 368 3349

## **Media Contacts**








### **Elizabeth Fogerty**

New York  
+1 212 908 0526  
elizabeth.fogerty@thefitchgroup.com

## Rating Actions

| ENTITY/DEBT                         | RATING    |  | RECOVERY | PRIOR    |
|-------------------------------------|-----------|--|----------|----------|
| AZUL<br>Investments<br>LLP          |           |  |          |          |
| • senior<br>unsecured <sup>LT</sup> | CCC+      | New Rating   | RR4      |          |
| • senior<br>unsecured <sup>LT</sup> | CCC+      | Affirmed   | RR4      | CCC+     |
| Azul S.A.                           | LT IDR    | CCC+  | Affirmed | CCC+     |
|                                     | LC LT IDR | CCC+  | Affirmed | CCC+     |
|                                     | Natl LT   | B(bra)   | Upgrade  | CCC(bra) |

### RATINGS KEY OUTLOOK WATCH

|          |   |   |
|----------|---|---|
| POSITIVE |  |  |
| NEGATIVE |  |  |
| EVOLVING |  |  |
| STABLE   |  |   |

### Applicable Criteria

[Corporate Rating Criteria \(pub.21 Dec 2020\) \(including rating assumption sensitivity\)](#)

[Corporates Recovery Ratings and Instrument Ratings Criteria \(pub.09 Apr 2021\) \(including rating assumption sensitivity\)](#)

[Country-Specific Treatment of Recovery Ratings Criteria \(pub.05 Jan 2021\)](#)

[National Scale Rating Criteria \(pub.22 Dec 2020\)](#)

[Parent and Subsidiary Linkage Rating Criteria \(pub.26 Aug 2020\)](#)

## Applicable Models

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

[Solicitation Status](#)

## Endorsement Status

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