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Fitch Downgrades AZUL to 'RD'; Upgrades to 'CCC' and Assigns Positive Outlook

Fitch Ratings - Rio de Janeiro - 03 Feb 2025: Fitch Ratings has downgraded Azul S.A.'s (Azul) Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) to 'RD' from 'C', following the conclusion of its exchange offer, which Fitch considered a distressed debt exchange (DDE). Fitch has also upgraded Azul's IDRs to 'CCC' from 'RD' to reflect its post-restructuring risk profile.

Fitch has downgraded Azul Investments LLP's unsecured bonds to 'RD' from 'C' with a Recovery Rating of 'RR6', Azul Secured Finance LLP's secured bonds to 'RD' from 'C' with a Recovery Rating of 'RR4' and Azul's Long-Term National Scale rating to 'RD(bra)' from 'C(bra)'. Fitch has upgraded Azul's secured bonds to 'CCC'/'RR4' from 'RD', unsecured bonds to 'CC'/'RR6' from 'RD' and Long-Term National Scale rating to 'CCC(bra)' from 'RD(bra)'. Fitch has also assigned Azul 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 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 USD500 million super priority 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 94 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 a 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% PIK.

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. Fitch believes these events carry high execution risk as they depend on market conditions and are not entirely within management's control. Therefore, Fitch cannot assume this as its base case scenario. Azul's ability to enhance its liquidity profile and manageable refinancing risks in the short to medium term could eventually further benefit its ratings.

Cash Flow Burn: Azul has been facing multiple challenges such as BRL devaluation, approximately 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. Fitch estimates EBITDA for 2024 to be close to BRL6 billion and BRL7.2 billion in 2025. Lease rental, interest, and capex are projected to total BRL7.3 billion in 2024 and BRL8 billion in 2025.

Effective Deleveraging Expected Late 2025: Azul's leverage is expected to peak in 2024 and decline during 2025, reaching 4.5x by 2026, according to Fitch's estimates. The ongoing improvements in EBITDA generation are expected to help restore its credit profile in the medium term. Fitch's base-case scenario forecasts the company's total and net adjusted leverage/EBITDAR ratios at around 6.2x and 6.0x, respectively, during 2024, declining 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. (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.

Derivation Summary

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. Azul is expected to report 1.3x of EBITDA coverage in 2024, while LATAM and Avianca should be at 2.3x and 4.2x, respectively.

Azul also has weaker liquidity, with cash over LTM revenues at about 10%-12%, compared to LATAM's 24% (including its revolving facility) and Avianca's approximately 15%-20%. LATAM has a sizable standby credit facility of USD1.1 billion.

Key Assumptions

--Fitch's base case during 2024 and 2025 includes an increase in ASK by 6% and 11%, respectively, and in RPK of 6% and 10%, respectively;

--Load factors around 80%-81% during 2024 and 2025;

-- Adjusted EBITDAR margin of around 30%-32% in 2024 and 2025;

--Capex of BRL1.4 billion in 2024 and BRL2.0 billion in 2025;

--Total debt of around BRL37 billion in 2024.

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 Sept. 30, 2024. These assumptions result in a recovery rate for the first lien 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 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 BRL6.4 billion (BRL1.6 billion of financial debt and BRL4.5 billion of leasing obligations) as of Sept. 30, 2024. Azul's readily available cash, per Fitch's criteria, declined to BRL1.1 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 BRL31.6 billion, and primarily consists of BRL14.3 billion of leasing obligations, BRL380 million of cross-border senior unsecured notes due 2024, BRL176 million due 2026, BRL9.7 billion of secured issuances due 2028, 2029 and 2030, BRL2.3 billion of other loans and financing, BRL3.5 billion of lessors equity/note, and BRL1.2 billion of convertible debentures.

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 2023, 93% of its revenues came from passengers, while 7% came from cargo and other sources.

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	RD	Downgrade	C
• senior unsecured	LT	CC	Upgrade	RR6
Azul S.A.	LT IDR	RD	Downgrade	C
	LT IDR	CCC +	Upgrade	
	LC LT IDR	RD	Downgrade	C
	LC LT IDR	CCC +	Upgrade	
	Natl LT	RD(bra)	Downgrade	C(bra)
	Natl LT	CCC(bra) +	Upgrade	
Azul Secured Finance LLP				
• senior secured	LT	RD	Downgrade	C
• senior secured	LT	CCC	Upgrade	RR4

ENTITY/DEBT	RATING		RECOVERY	PRIOR
• Senior Secured 2nd Lien	LT	RD	Downgrade	C
• Senior Secured 2nd Lien	LT	CCC	Upgrade	RR4

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).

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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The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each 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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