

**Rating Action: Moody's downgrades Azul to Caa1 from B1; outlook negative**

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02 Jun 2020

New York, June 02, 2020 -- Moody's Investors Service has today downgraded Azul S.A.'s (Azul) corporate family rating to Caa1 from B1. At the same time, Moody's downgraded the USD400 million senior unsecured notes issued by Azul Investments LLP and guaranteed by Azul and Azul Linhas Aéreas Brasileiras S.A. to Caa2 from B2. The outlook is negative. This concludes the review initiated on 17 March 2020.

Downgrades:

..Issuer: Azul S.A.

.... Corporate Family Rating, Downgraded to Caa1 from B1

..Issuer: Azul Investments LLP

....Gtd Senior Unsecured Regular Bond/Debenture, Downgraded to Caa2 from B2

Outlook Actions:

..Issuer: Azul S.A.

....Outlook, Changed To Negative From Rating Under Review

..Issuer: Azul Investments LLP

....Outlook, Changed To Negative From Rating Under Review

RATINGS RATIONALE

The downgrade to Caa1 reflects a sharper decline in passenger traffic than initially anticipated and a slower recovery that will prevent passenger demand from reaching 2019 levels before 2023. The International Air Travel Association's (IATA) latest scenario analysis forecasts a decline in global passenger numbers of around 24% for the full year 2020 while 2019 levels will not be exceeded until 2023. Since the outbreak of coronavirus Azul has been experiencing cash burn, which is resulting in a weakening liquidity profile and a significantly higher leverage depending on the duration of the coronavirus outbreak. The rating action concludes the review initiated on March 17 2020.

The rapid and widening spread of the coronavirus outbreak, deteriorating global economic outlook, falling oil prices, and asset price declines are creating a severe and extensive credit shock across many sectors, regions and markets. The combined credit effects of these developments are unprecedented. The passenger airline sector has been one of the sectors most significantly affected by the shock given its exposure to travel restrictions and sensitivity to consumer demand and sentiment. More specifically, the weaknesses in Azul's credit profile have left it vulnerable to shifts in market sentiment in these unprecedented operating conditions and Azul remains vulnerable to the outbreak continuing to spread. Today's action reflects the impact on Azul of the breadth and severity of the shock, and the broad deterioration in credit quality it has triggered. We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety.

Moody's base case assumptions are that the coronavirus pandemic will lead to a period of severe cuts in passenger traffic for 2020 with partial or full flight cancellations and aircraft groundings, with all regions affected globally. The base case assumes a gradual recovery in passenger volumes starting in the third quarter. However, there are high risks of more challenging downside scenarios and the severity and duration of the pandemic and travel restrictions is uncertain. Moody's analysis assumes a reduction of around 50 % in Azul's passenger traffic for the full year 2020 and a 20% reduction for 2021, with volumes recovering to 2019 levels only by 2023.

Moreover, the economic slowdown in Latin American coupled with increased risk aversion is driving the sharp

devaluation in local currencies in the region. Accordingly, Azul is particularly exposed to the depreciation of the Brazilian Real, which accounts for about 80% of the company's revenues. This effect is only partially mitigated by the important reduction in fuel prices.

Moody's anticipates that the airline industry will require continued and further support from regulators, national governments and labor representatives to alleviate pressures on slot allocations, provide indirect or direct financial support and manage airlines' cost bases. Although there is nothing concrete yet, the Brazilian government announced that it is considering measures to support the airlines operating in Brazil including, but not limited to long term credit lines and working capital lines to be provided by state owned banks as well as allowing the companies to defer tax payments.

## LIQUIDITY

Moody's estimates that Azul had around BRL1.3 billion in cash at the end of April 2020 for a daily cash burn of around BRL4 million. The company has been taking all necessary measures to reduce cash burn such as 50% salary reduction expected in 2Q20, while 78% of the workforce joined an unpaid leave of absence program. The company has also been able to significantly reduce costs through the negotiation of favorable payment terms with all suppliers and lessors. Still the company has substantial amount of lease payments due in 2020 that could quickly erode its liquidity forcing the company to search alternative sources of liquidity such as the BNDES or the financial markets.

The negative outlook reflects the potential for greater than already anticipated adverse impact from the coronavirus crisis, which would consume more of the company's liquidity and delay the pace and scope of the recovery in demand, the retirement of debt, and the strengthening of credit metrics relative to Moody's current expectations.

## FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

The ratings are unlikely to be upgraded in the short term. Positive rating pressure would not arise until the risk of a default is reduced significantly because of a large increase in liquidity while the coronavirus outbreak is brought under control and travel restrictions are lifted. Positive rating pressure would require evidence that the company can avoid a default while recovering its financial metrics and restoring liquidity.

Moody's could further downgrade Azul if:

- wider liquidity concerns increase
- there are increased expectations of a default in the company's financial obligations and increased expectations of losses to creditors
- the company executes debt restructuring or filing for bankruptcy

## PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Passenger Airline Industry published in April 2018 and available at [https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC\\_1091811](https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1091811) .

Alternatively, please see the Rating Methodologies page on [www.moodys.com](http://www.moodys.com) for a copy of this methodology.

## COMPANY PROFILE

Headquartered in Barueri near the City of Sao Paulo, Brazil, Azul S.A. (Azul) is a Brazilian airline founded by David Neeleman in 2008. The company is the largest airline in Brazil by number of cities and departures, serving 116 destinations with an operating fleet of 142 aircraft and operating 916 flights daily. The company also flies its aircraft to select international destinations, including Fort Lauderdale, Orlando and Lisbon. Azul is the sole owner of the loyalty program TudoAzul, a strategic revenue-generating asset, which had around 12 million members in the end of 2019. In 2019 Azul generated BRL11.4 billion in net revenue and carried almost 28 million passengers.

## REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: [https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC\\_79004](https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004).

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Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at [https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC\\_1133569](https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1133569).

At least one ESG consideration was material to the credit rating action(s) announced and described above.

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