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Research Update:

Brazilian Airline Azul S.A. Downgraded To 'CCC-' From 'CCC+' On Elevated Default Risk; Outlook Negative

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Rating Action Overview

- Brazilian-based airline company Azul S.A.'s liquidity continues to erode due to material cash burn in the first quarter of 2025.
- The company faces material cash outflows related to high lease and financial expenses, and we think access to additional financing is highly restricted following two debt restructurings in recent years.
- Therefore, we lowered our issuer credit rating on Azul to 'CCC-' from 'CCC+'. At the same time, we lowered our issue rating on the company's senior unsecured notes due 2026 to 'CC' from 'CCC-'; the '6' recovery rating is unchanged. We also lowered our national scale rating to 'brCCC-' from 'brBB+'.
- The negative outlook reflects the increased likelihood of a default in the next six to 12 months.

Rating Action Rationale

The downgrade reflects our view that Azul's very tight liquidity increases default risk within the next few months. As of March 31, 2025, Azul's cash and liquid investments amounted to approximately R$655 million. Although the company successfully raised R$600 million in additional funding from bondholders, this is a short-term bridge financing with a 120-day maturity.

While Azul's debt maturities are not particularly substantial--totaling around R$730 million over the next 12 months--the company's obligations related to operating lease payments, interest expenses, working capital, and capital expenditures (capex) are considerable. We estimate these needs are R$7.4 billion-R$7.8 billion over the same period.

Azul raised R$3.0 billion through new superpriority notes during its debt restructuring earlier this year but still reported cash burn of almost R$750 million in the first quarter. In the first three months of the year, the company reported an operating cash flow deficit of R$313 million, driven by substantial interest expenses, working capital outflows, and restructuring-related costs. Additionally, Azul paid slightly over R$1.0 billion in leases and about R$1.9 billion in debt maturities.

Azul's operating results in the first quarter fell short of our expectations, and we now forecast material negative free operating cash flow (FOCF) after lease payments. The main reasons for the weaker performance were depreciation of the Brazilian real (R$) and rising fuel prices. We do anticipate healthy demand, alongside lower fuel prices and a more favorable exchange rate for the remainder of the year, which should contribute to revenue and EBITDA growth in 2025.

We now estimate approximately 10% revenue growth for 2025, with EBITDA expected to rise to about R$6.8 billion this year, up from R$5.9 billion in 2024. However, given the substantial lease payments, working capital requirements, other financial expenses, and capx, we forecast significant FOCF deficits after lease payments of R$1.6 billion-R$1.8 billion for 2025.

Over the past two years, Azul has undergone two debt restructurings, neither of which has provided adequate relief to its capital structure and cash flows. Despite reporting strong operating margins, the company's high debt burden and lease expenses leave it highly vulnerable to downturns in the industry or broader macroeconomic challenges. We believe until Azul can demonstrate improved cash flow generation and liquidity, access to capital markets (either for new financing or equity follow-on) is largely restricted.

Azul is working on potential new financing using a guarantee from the Brazilian Export Guarantee Fund (FGE) to finance fuel purchases. This financing could amount to up to R$2.0 billion and could provide some liquidity relief and facilitate negotiations with investors.

Outlook

The negative outlook reflects the increased short-term liquidity pressures and our view that we could lower our ratings on Azul if it pursues a new debt restructuring within the next six to 12 months or is unable to pay its financial obligations.

Downside scenario

We could downgrade Azul if:

- We believe a default is a virtual certainty;
- The company announces or undertakes another distressed restructuring that we could consider equivalent to a default; or
- The company pursues a legal restructuring.

Upside scenario

A positive rating action could result from significant liquidity relief amid stronger-than-expected recovery in its cash flows. It could also stem from new cash proceeds from new long-term funding--for instance, if the company manages to get financing with FGE guarantees.

Company Description

Azul is a Brazilian airline founded in 2008 with a total fleet of 184 operating aircraft as of March 2025. The company is the country's largest airline in terms of domestic departures and cities it serves, with more than 1,000 daily flights reaching over 150 cities. In addition, the company wholly owns its loyalty program, Azul Fidelidade, which had almost 19 million members as of March 2025. Azul generated revenue of about R$20.2 billion and EBITDA of R$5.9 billion in the rolling 12 months as of March 2025.

Our Base-Case Scenario

Assumptions

- GDP growth in Brazil of 1.8% in 2025 and 1.7% in 2026.
- Inflation in Brazil of 5.2% in 2025 and 4.7% in 2026, affecting Azul's local costs, including selling, general, and administrative costs and some costs of goods sold (for instance, salaries).
- Average and year-end exchange rates of R$5.8-R$5.85 over the next two years, which affects fuel prices, maintenance costs, leasing payments, and the debt burden.
- Persistent capacity expansion for domestic and international travel, with available seat kilometers growing by about 11% in 2025 and 8% in 2026.
- Load factor of about 82% for the forecast period.
- West Texas Intermediate crude oil prices of about $63 in 2025 and $65 in 2026.
- Average yields falling 1% in 2025 and 2026.
- Capex of R$1.7 billion in 2025 and about R$2 billion in 2026.
- Conversion into equity of 35% of the 2029 and 2030 notes during 2025.
- No dividends in the next two years.

Key metrics

Azul S.A.--Forecast summary

Period ending	Dec-31-2021	Dec-31-2022	Dec-31-2023	Dec-31-2024	Dec-31-2025	Dec-31-2026	Dec-31-2027
(Mil. BRL)	2021a	2022a	2023a	2024a	2025e	2026f	2027f
Revenue	9,976	15,948	18,554	19,526	21,580	23,158	24,702
Gross profit	3,396	4,881	5,770	7,847	9,105	9,500	10,356
EBITDA (reported)	1,599	3,524	4,065	5,955	6,817	7,161	7,861
Plus: Operating lease adjustment (OLA) rent	--	--	--	--	--	--	--
Plus/(less): Other	(507)	(846)	616	17	43	43	43
EBITDA	1,092	2,678	4,681	5,971	6,861	7,204	7,904
Less: Cash interest paid	(625)	(1,170)	(1,725)	(2,073)	(3,779)	(4,073)	(4,271)
Less: Cash taxes paid	--	--	--	--	--	(31)	(56)
Plus/(less): Other	--	--	--	--	--	--	--

Azul S.A.--Forecast summary

Funds from operations (FFO)	467	1,508	2,956	3,898	3,082	3,099	3,578
EBIT	(320)	879	2,426	3,603	4,005	4,129	4,603
Interest expense	3,604	4,491	5,240	5,233	4,301	4,130	4,381
Cash flow from operations (CFO)	(311)	2,437	3,440	2,787	1,692	3,059	3,350
Capital expenditure (capex)	777	1,451	972	1,494	1,700	2,050	2,050
Free operating cash flow (FOCF)	(1,087)	986	2,467	1,293	(8)	1,009	1,300
Dividends	--	--	--	--	--	--	--
Share repurchases (reported)	16	4	7	3	--	--	--
Discretionary cash flow (DCF)	(1,104)	982	2,461	1,291	(8)	1,009	1,300
Debt (reported)	10,019	8,636	10,901	16,164	16,079	16,273	16,556
Plus: Lease liabilities debt	14,891	14,583	15,146	21,379	18,288	21,157	23,302
Plus: Pension and other postretirement debt	--	--	--	--	--	--	--
Less: Accessible cash and liquid Investments	--	--	--	--	--	--	--
Plus/(less): Other	106	378	(128)	(688)	--	--	--
Debt	25,015	23,598	25,919	36,855	34,367	37,430	39,859
Equity	(18,333)	(19,008)	(21,328)	(30,435)	(30,982)	(30,844)	(30,634)
FOCF (adjusted for lease capex)	(3,283)	(1,951)	312	(2,931)	1,232	(3,491)	(2,200)
Interest expense (reported)	3,604	4,491	5,240	5,233	4,301	4,130	4,381
Capex (reported)	777	1,451	972	1,494	1,700	2,050	2,050
Cash and short-term investments (reported)	3,075	668	1,897	1,282	1,615	1,100	1,100
Adjusted ratios							
Debt/EBITDA (x)	22.9	8.8	5.5	6.2	5.0	5.2	5.0
FFO/debt (%)	1.9	6.4	11.4	10.6	9.0	8.3	9.0
FFO cash interest coverage (x)	1.7	2.3	2.7	2.9	1.8	1.8	1.8
EBITDA interest coverage (x)	0.3	0.6	0.9	1.1	1.6	1.7	1.8
CFO/debt (%)	(1.2)	10.3	13.3	7.6	4.9	8.2	8.4
FOCF/debt (%)	(4.3)	4.2	9.5	3.5	(0.0)	2.7	3.3
DCF/debt (%)	(4.4)	4.2	9.5	3.5	(0.0)	2.7	3.3
Lease capex-adjusted FOCF/debt (%)	(13.1)	(8.3)	1.2	(8.0)	3.6	(9.3)	(5.5)
Annual revenue growth (%)	73.7	59.9	16.3	5.2	10.5	7.3	6.7
Gross margin (%)	34.0	30.6	31.1	40.2	42.2	41.0	41.9
EBITDA margin (%)	10.9	16.8	25.2	30.6	31.8	31.1	32.0
Return on capital (%)	(5.1)	15.6	52.8	65.4	81.7	82.8	58.2
Return on total assets (%)	(1.9)	4.7	12.4	15.4	16.6	17.5	17.5
EBITDA/cash interest (x)	1.7	2.3	2.7	2.9	1.8	1.8	1.9
EBIT interest coverage (x)	(0.1)	0.2	0.5	0.7	0.9	1.0	1.1
Debt/debt and equity (%)	374.4	514.1	564.5	574.1	1,015.4	568.3	432.1
Debt fixed-charge coverage (x)	0.3	0.6	0.9	1.1	0.6	1.6	1.8

Azul S.A.--Forecast summary

Debt/debt and undepreciated equity (%)	374.4	514.1	564.5	574.1	1,015.4	568.3	432.1

All figures are adjusted by S&P Global Ratings, unless stated as reported. a--Actual. e--Estimate. f--Forecast. R$--Brazilian real.

Liquidity

We assess Azul's liquidity as weak, mainly reflecting the limited cash balances, expected cash burn in 2025, and the limited access to financing after it rebuilds a track record following two debt restructurings.

We expect sources over uses of liquidity to be about 0.7x in the next 12 months. Although the company does not face material debt maturities in this period, large lease payments and working capital needs combined with weak cash balances pose material liquidity risks. Furthermore, we believe that Azul's standing in credit markets and access to financing will remain very limited until it shows consistent improvement in cash flow generation.

Principal liquidity sources

- Unrestricted short-term cash of R$655 million as of March 2025.
- Cash funds from operations after lease payments of about R$470 million in the next 12 months.
- Proceeds from new common shares subscribed by existing shareholders of R$72 million.

Principal liquidity uses

- Short-term debt of about R$730 million in the next 12 months.
- Working capital needs of about R$230 million in the next 12 months.
- Minimum capex of about R$800 million over the next 12 months.

Covenants

We expect Azul to breach leverage covenants in 2025 and 2026.

The company has debt acceleration and restrictions covenants on its debentures, senior notes, and other financings that require:

- Maintenance of minimum immediate liquidity. As of March 2025, it had a waiver in some of these (these are measured quarterly);
- Debt to EBITDA below 3.75x, 5.0x, or 5.5x depending on the debt (these are measured only annually); and
- Fixed-charge interest coverage greater than 1.2x.

Issue Ratings--Recovery Analysis

Key analytical factors

- Our 'CC' issue rating on Azul's 2026 unsecured notes is lower than our issuer credit rating on the company. The '6' recovery rating indicates no recovery expectations in a distressed scenario for unsecured creditors, which reflects the significant subordination the unsecured notes have. The superpriority notes now rank ahead of all other debt. These new notes add to an already large portion of secured debt that includes the first-lien 2028, second-lien 2029, and 2030 notes; convertible notes; and engine facilities.
- We have valued Azul on a discrete-asset basis (discrete asset valuation), although we believe that it would reorganize successfully and continue to operate following a hypothetical default. Our analysis under the going-concern scenario reflects the size of the company's operations in Brazil. We reflect our estimate of the value of the assets at default based on net book value for current assets and appraisals for aircraft, after adjusting for expected realization rates in a distressed scenario.

Simulated default assumptions

- Simulated year of default: 2025
- We apply an overall haircut of about 56% to Azul's asset base, including a haircut of about 36% to its cash, because the company would likely use part of its cash position to fund working capital needs and repay more expensive loans in a distressed scenario.
- An effective realization of about 65% of receivables.
- For intangibles, including slots, we use an effective realization rate of about 55%.
- Therefore, we arrive at a gross enterprise value of about R$4.9 billion.

Simplified waterfall

- Net enterprise value after administrative costs (5%): R$4.6 billion
- First-priority debt at default including six months of accrued interest: R$3.0 billion
- Total secured debt, including priority: R$16.1 billion
- As a result, there's no residual value available to unsecured claims.
- Senior unsecured notes/lease rejected claims at default: R$2.3 billion
- Recovery expectations for unsecured notes due 2026: 0%

Related Criteria

- Criteria | Corporates | General: Sector-Specific Corporate Methodology, April 4, 2024
- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- General Criteria: National And Regional Scale Credit Ratings Methodology, June 8, 2023

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- Criteria | Corporates | Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings, Oct. 1, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Brazilian Airline Azul S.A. Downgraded To 'SD' Following Distressed Debt Exchange, Jan. 29, 2025

Ratings List

Ratings list		
Downgraded; Outlook Action		
	To	**From**
Azul S.A.		
Issuer Credit Rating	CCC-/Negative/--	CCC+/Positive/--
Brazil National Scale	brCCC-/Negative/--	brBB+/Positive/--
Downgraded; Recovery Ratings Unchanged		
	To	**From**
Azul Investments LLP		
Senior Unsecured	CC	CCC-
Recovery Rating	6(0%)	6(0%)

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