MOODY'S
RATINGS

Announcement: Moody's Ratings says Azul's Caa2 CFR and negative outlook unaffected by proposed exchange offer

18 Dec 2024

New York, December 18, 2024 -- Moody's Ratings (Moody's) comments that Azul S.A. (Azul)'s Caa2 corporate family rating (CFR), the Caa1 rating of the backed senior secured first lien debt and Caa2 rating of the backed senior secured debts of Azul Secured Finance LLP (Delaware), and the Caa3 backed senior unsecured debt ratings of Azul Investments LLP and negative outlook remain unchanged following the company's announcement of an exchange offer for its 2028, 2029 and 2030 notes.

On December 18, Azul announced an exchange offer and a consent solicitation as part of its debt restructuring. The deal consists of an exchange offer for its $807 million (around BRL5 billion) notes due 2029 and 2030 in which the noteholders will immediately convert 10% of the notes' principal amount into equity and 52.5% into a new convertible instrument that will bear a 10% interest rate (4% cash payment and 6% PIK). Upon the receipt of an additional $100 million in new money through the issuance of a new superpriority note, Azul will be able to convert an additional 25% of the notes' principal into equity, and upon a future capital increase, Azul will be able to convert the remaining 12.5% into equity. The equity conversion will be priced based on the shares' trading prices plus a discount. Azul also announced an exchange offer for its around $1 billion notes due 2028, in which noteholders will exchange the notes for new notes mirroring the existing ones; bondholders will have to consent to the assignment of Azul's cargo business as collateral, the pledge of the collateral of the 2028 notes to the new superpriority notes and subordination of the instrument to second-lien vis-à-vis the new superpriority notes, which will be first lien. The offer also eliminates substantially all of the restrictive covenants, events of default and related provisions in a customary exit consent solicitation and releases the collateral securing the existing notes, meaning that the remaining outstanding notes after the exchange will be unsecured. We view the deals as a distressed exchange given the conversion of debt into equity and that the exchange offer avoids a potential default in light of Azul's weak liquidity and untenable capital structure.

The transaction is part of a broader debt restructure that will improve Azul's capital structure and liquidity. In addition to the exchange offer, Azul announced agreements with an ad-hoc group of creditors to provide up to $500 million through the issuance of superpriority notes, including $150 million already provided on October 2024, an additional $250 million expected in January 2025, and the release of a further $100 million upon meeting specific conditions, including cost savings of at least $75 million per year in 2025, 2026 and 2027. The exchange offers are a precedent condition to the issuance of the superpriority notes. Azul expects to conclude the exchange offers and to issue the superpriority notes in mid-January 2025.

Earlier on October 2024, Azul announced that it had reached commercial agreements with lessors and OEMs. Under these agreements, lessors and OEMs agreed to eliminate their pro-rata share of the current balance of the equity issuance obligations totaling BRL3.1 billion ($550 million) and, in exchange, to receive up to 100 million new preferred shares of Azul in a one-time issuance. The agreement is subject to the completion of the issuance of the superpriority notes.

The exchange offer and other transactions will help alleviate Azul's cash needs in the medium term, and will lead to a reduction in total debt through the potential equitization of up to $807 million of existing debt, leading to an additional reduction of almost $100 million in interest payments per year. Azul's total debt could decline by up to $900 million upon the conclusion of the transactions and depending on the treatment of the new convertible instrument. The company's cash position will increase by $400 million with the new superpriority notes, potentially increasing by up to $500 million (with additional $100 million superpriority notes) if the company is able to save at least $75 million in cash flows per year.

Even so, liquidity risks remains high and its balance sheet highly leveraged. Azul generated BRL3.2 billion in EBIT in the twelve months that ended in September 2024, but high working capital needs and debt burden led to a cumulative cash burn of BRL260 million in the same period. Azul's cash position declined to BRL1.1 billion at the end of September 2024 from BRL1.9 billion at the end of 2023, and the company will still have around BRL4.5 billion in financial and lease obligations coming due until the end of 2025 pro forma to the conclusion of the transactions. Its cash position could increase to up to BRL4 billion with the debt restructure and new money, but its total leverage would still be at around 4x or higher assuming a recurring EBITDA of about BRL6 billion, and the company will still face operational headwind related to the depreciation of the local currency.

The negative outlook reflects Azul's tight liquidity profile and the company's reliance on additional renegotiations with lessors or additional refinancing initiatives that could be considered distressed exchanges to remain solvent.

We could downgrade Azul's ratings if liquidity concerns increase, or the company is unable to strengthen its credit metrics further increasing the risk of default on its financial obligations.

We could upgrade Azul's ratings if risks and uncertainties reduce significantly, and passenger demand exceeds pre-pandemic levels on a sustained basis. An upgrade would also require Azul to continue to improve its capital structure; maintain adequate liquidity, with cash consistently above 15% of revenue; and improve key metrics, with debt/EBITDA below 6x and (funds from operations + interest)/interest above 3x on a sustained basis.

Azul S.A. is a Brazilian airline founded in 2008. The company is the largest airline in Brazil by number of cities covered and departures, serving more than 160 destinations with an operating fleet of 182 aircraft and operating more than 900 flights daily. The company also flies its aircraft to select International destinations, including Fort Lauderdale, Orlando, Paris, Punta del Este, Montevideo, Lisbon and Curaçao.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the issuer/deal page on https://ratings.moodys.com for the most updated credit rating action information and rating history.

Carolina Chimenti
Vice President - Senior Analyst

Marcos Schmidt
Associate Managing Director

Releasing Office:
Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
U.S.A.
JOURNALISTS: 1 212 553 0376
Client Service: 1 212 553 1653

---

and preferred stock rated by Moody's Investors Service, Inc. have, prior to assignment of any credit rating, agreed to pay to Moody's Investors Service, Inc. for credit ratings opinions and services rendered by it fees ranging from $1,000 to approximately $5,000,000. MCO and Moody's Investors Service also maintain policies and procedures to address the independence of Moody's Investors Service credit ratings and credit rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold credit ratings from Moody's Investors Service, Inc. and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at www.moodys.com under the heading "Investor Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

Additional terms for Australia only: Any publication into Australia of this document is pursuant to the Australian Financial Services License of MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657AFSL 336969 and/or Moody's Analytics Australia Pty Ltd ABN 94 105 136 972 AFSL 383569 (as applicable). This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001. MOODY'S credit rating is an opinion as to the creditworthiness of a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail investors.

Additional terms for Japan only: Moody's Japan K.K. ("MJKK") is a wholly-owned credit rating agency subsidiary of Moody's Group Japan G.K., which is wholly-owned by Moody's Overseas Holdings Inc., a wholly-owned subsidiary of MCO. Moody's SF Japan K.K. ("MSFJ") is a wholly-owned credit rating agency subsidiary of MJKK. MSFJ is not a Nationally Recognized Statistical Rating Organization ("NRSRO"). Therefore, credit ratings assigned by MSFJ are Non-NRSRO Credit Ratings. Non-NRSRO Credit Ratings are assigned by an entity that is not a NRSRO and, consequently, the rated obligation will not qualify for certain types of treatment under U.S. laws. MJKK and MSFJ are credit rating agencies registered with the Japan Financial Services Agency and their registration numbers are FSA Commissioner (Ratings) No. 2 and 3 respectively.

MJKK or MSFJ (as applicable) hereby disclose that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MJKK or MSFJ (as applicable) have, prior to assignment of any credit rating, agreed to pay to MJKK or MSFJ (as applicable) for credit ratings opinions and services rendered by it fees ranging from JPY100,000 to approximately JPY550,000,000.

MJKK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements.