

19 DEC 2024

## Fitch Downgrades Azul's IDRs to 'C' on Announcement of Exchange Offer

Fitch Ratings - Rio de Janeiro - 19 Dec 2024: Fitch Ratings has downgraded Azul S.A.'s Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) to 'C' from 'CC', and National Scale Rating to 'C(bra)' from 'CC(bra)'. Additionally, Fitch has downgraded Azul Secured Finance LLP's senior secured notes to 'C' with a Recovery Rating of 'RR4' from 'CC'/'RR4' and has affirmed Azul Investments LLP's unsecured notes at 'C'/'RR6'.

The downgrades follow Azul's announcement of exchange offers for existing senior secured first-out notes due 2028 and senior secured second-out notes due 2029 and 2030 into newly senior secured first- and second-out notes. Fitch considers this transaction a distressed debt exchange (DDE) per its criteria. The transaction will not cause an immediate debt haircut nor a maturity extension but it will worsen terms with structural subordination for bondholders and potential phased equitization. Any remaining existing notes post-exchange will become unsecured obligations.

### Key Rating Drivers

**Transaction Qualifies as DDE:** The transaction will qualify as a DDE under Fitch's criteria if approved, due to terms deterioration for bondholders and the involvement of a substantial portion of Azul's classes of obligors. This deal is part of a broader debt restructuring plan, including renegotiations with lessors and original equipment manufacturers (OEMs), and new debt issuance pending exchange offer. These transactions aim to enhance liquidity and capital structure, ultimately avoiding future default payments.

**Exchange Offer Overview:** Azul has entered a transaction agreement with an ad hoc group of note holders for existing 2028, 2029, and 2030 secured notes (66.7% participation) and convertible debentures (95.6%). Supporting bondholders agreed to provide USD150 million in financing with a 90-day maturity, during which Azul is to meet conditions for additional superpriority financing. An additional USD250 million will be disbursed, with a potential USD 100 million contingent on further cash flow improvements.

The new financing will be issued by Azul Secured Finance II LLP and guaranteed by Azul and certain of its subsidiaries and will be secured by: (i) certain receivables generated by, and intellectual property used in, the Azul Cargo business, (ii) a pledge of certain financial assets held by Azul, (iii) certain credit and debit card receivables generated by Azul's passenger airline business, and (iv) the shared collateral that currently secures the existing 2028, 2029 and 2030 notes.

**Restricted Default and Re-Rate:** Azul's IDR will likely be downgraded to Restricted Default (RD) if the

proposed transaction is completed successfully. Fitch will then re-rate the company's IDRs based on its forecast sustainable capital structure, liquidity, debt risk profile, and airline industry risks. Once completed, any remaining existing unsecured bonds will likely be upgraded to levels below the new IDR due to their lower degree of credit protection and priority in the capital structure.

**Successful Restructuring to Improve Liquidity:** Once the proposed restructuring is fully completed, Azul is expected to add around USD500 million in new funds. The company is also exploring additional cash options via a guaranteed local credit line (Fundo Nacional de Aviação - FNAC) and a potential follow-on issuance. These efforts carry execution risks, as they depend on market conditions and are not fully within management's control. Azul's ability to maintain sound liquidity profile and manageable refinancing risks in the short to medium term could eventually enhance its ratings.

**Effective Deleveraging Expected by 2026:** Azul's leverage is expected to peak in 2024 and decline during 2025, reaching below 4.5x only 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 5.7x and 5.5x, respectively, during 2024, reducing to 5.0x and 4.7x in 2025, and 4.8x and 4.5x in 2026. Fitch calculates Azul's total debt at BRL33.9 billion by year-end Dec. 31, 2024.

**Above-Average Industry Risks:** The airline industry is high-risk sector due to its cyclical, capital-intensive nature and vulnerability to external shocks. High fixed costs and fluctuating demand and fuel prices lead to volatile profits and cash flows. Latin American airlines face added risks from foreign exchange fluctuations, with costs in U.S. dollars and revenues in local currency. Azul is particularly affected, as its operations are primarily in Brazil, where the BRL is facing meaningful oscillation.

## Derivation Summary

Azul's 'C' rating reflects its exchange offer announcement, deemed a DDE by Fitch. This occurs amid high refinancing risks and cash flow pressures. The company holds a strong market position in Brazil's domestic airline market, serving as the sole airline on 80% of its routes.

Azul has a weaker business and financial position compared to LATAM Airlines Group S.A (BB-/Positive Outlook), which has a more diversified business model, significant regional market position, strong capital structure and robust liquidity position. Azul's rating is also weaker than Avianca Group International Limited (B/Stable), mostly reflecting relatively higher leverage ratios, lower refinancing risks and liquidity profile.

## 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, plus 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 the 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 September 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 'RR2' range, but, due to the soft cap of Brazil at 'RR4', Azul's senior secured are rated at 'C'/RR4'. For the unsecured notes, the recovery is in the 'RR6' range, resulting in a rating of 'C'/RR6'.

## **RATING SENSITIVITIES**

### **Factors That Could, Individually Or Collectively, Lead To A Negative Rating Action/Downgrade**

--An uncured payment default on any material financial obligation would lead to a downgrade of the IDRs to 'RD'.

### **Factors That Could, Individually Or Collectively, Lead To Positive Rating Action/Upgrade**

--Completion of the proposed exchange offer will lead to a downgrade of the Long-Term IDRs to 'RD' and then subsequently to an upgrade to a rating level that reflects the post-DDE credit profile.

## **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 end of December 2023. According to Fitch's estimates, Azul would not be able to generate enough cash flow nor has sufficient liquidity to fulfil 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, and 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 local airlines, with significant presence in the regional market and being the sole player on 82% of its routes. During 2023, 93% of its revenues were derived from passengers and 7% from cargo and others.

## **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			

ENTITY/DEBT	RATING		RECOVERY	PRIOR
Investments LLP				
• senior unsecured	LT C		Affirmed RR6	C
Azul S.A.	LT IDR C		Downgrade	CC
	LC LT IDR C		Downgrade	CC
	Natl LT C(bra)		Downgrade	CC(bra)
Azul Secured Finance LLP				
• senior secured	LT C		Downgrade RR4	CC
• Senior Secured 2nd Lien	LT C		Downgrade RR4	CC

#### 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)

## 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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