Research Update:

Brazilian Airline Azul S.A. Upgraded To 'CCC+' From 'SD' Following Debt Restructuring; Outlook Positive

January 31, 2025

Primary contact

Amalia E Bulacios
Buenos Aires
54-11-4891-2141
amalia.bulacios
@spglobal.com

Secondary contact

Luisa Vilhena
Sao Paulo
55-11-3039-9727
luisa.vilhena
@spglobal.com

Rating Action Overview

- We reassessed the credit profile of Brazil-based airline Azul S.A. (Azul) following its debt exchange, lease liabilities renegotiation, and the issuance of super priority notes.
- As a result, the company has improved its liquidity and somewhat reduced debt but cash flow could be threatened by macroeconomic volatility.
- We raised our long-term issuer credit rating on Azul to 'CCC+' from 'SD' (selective default) and our national scale rating to 'brBB+' from 'SD'. We also affirmed our 'CCC-' issue rating on Azul's 2026 senior unsecured notes, for which the recovery rating remains '6', indicating our expectation of minimal recovery (0%) in the event of a payment default.
- The positive outlook reflects our expectation that capacity growth and a strong yield environment will support sound EBITDA margins, reduce leverage below 5.0x, and improve funds from operations (FFO) to debt close to or above 10% by year-end 2025.

Rating Action Rationale

The upgrade reflects Azul's successful debt restructuring and somewhat improved capital structure. On Jan. 28, 2025, Azul completed the settlement of the debt exchange for its 2028, 2029, and 2030 secured notes and convertible notes and issued super priority 2030 notes. The exchange had an aggregated acceptance of over 97%. This transaction does not push forward maturity dates, which are already well in the future, nor contemplates capital haircuts. However, it incorporates conversion into equity of some obligations and some relief in cash interest expenses, with some debt having payment-in-kind (PIK) options. The settlement of the exchange was a precondition to complete the conversion into equity of some lease obligations, together with the elimination of other leases. Additionally, after the settlement, 35% of the new 2029 and 2030 notes will be converted into equity. Another 12.5% of the new 2029 and 2030 notes will be converted upon an equity issuance of at least $200 million. The remaining 52.5% of notes will be exchangeable by Azul if the stock price is 75% above the strike price. In line with this, Brazilian real (R$) 3.1 billion from leases obligations and 35% of the 2029 and 2030 notes (about R$1.7 billion) will be converted into equity and another R$1.2 billion of leases will be ended, reducing existing debt.

The company's liquidity prospects have improved. Together with the exchanges, Azul has raised $500 million in super priority notes, of which $150 million will be used to immediately repay the bridge financing received in October 2024. The super priority notes will have a first lien on the collateral shared with exchanged 2028, 2029, and 2030 notes and add Azul Cargo and TAP Air Portugal notes to the collateral. Azul also has the option to pay interest on these notes in cash or in kind. The increased cash position and absence of significant individual maturities during 2025 and 2026 brings considerable relief to the company’s liquidity position.

However, Azul will remain highly leveraged. We estimate S&P Global Ratings-adjusted debt of about R$33 billion (which includes leases and convertible notes) by year-end 2024, with a decline by about R$2.5 billion in 2025 (we include the new exchangeable notes in our adjusted debt) following the restructuring. This is because the reduction of about R$6 billion of leases and debt will be partially offset by the issuance of the new super priority notes and the PIK on some of the new debt. On top of this, we forecast meagre FOCF in the next two years, preventing faster deleveraging. Yet, amid improved operational performance, we expect S&P Global Ratings-adjusted debt to EBITDA to dip below 5.0x in 2025 from 5.8x in 2024.

We expect Azul to maintain sound operating results but still slim FOCF in the next two years. In our view, Azul's capacity (available seat kilometers; ASK) should grow about 10%-11% in 2025, in line with expected aircraft deliveries (between 12 and 15 E2s) and we expect largely stable average yields. Downward pressure could hit yields amid increased market capacity, sluggish economic growth, and high interest rates, but we think the more depreciated Brazilian real will mean airlines try to pass through cost increases, preventing yields from falling. Additionally, we expect the three largest domestic airlines to maintain rational behavior in terms of pricing, like the past two years, underpinning fares. As a result, in our base case, we assume Azul's adjusted EBITDA will jump to about R$6.6 billion in 2025 from an estimated R$5.6 billion-R$5.7 billion in 2024. However, we expect operating cash flow (after interest expenses) to barely cover capital expenditure (capex; about R$1.8 billion) and lease payments (about R$3.2 billion). Furthermore, even though we forecast Azul will continue growing revenue and EBITDA into 2026, we also assume slightly higher capex that year. In turn, we expect FOCF after lease payments of R$100 million-R$300 million in the next two years.

We believe the company will have to rely on relatively favorable economic and industry conditions to deleverage. Softening macroeconomic conditions in Brazil or further real depreciation could result in weaker-than-expected demand or fares or higher costs and rapidly lead to unsustainable cash flows for Azul. This is because an increase of about 10% in fuel prices or drops of 4% in yields from our base-case scenario could cause EBITDA to decline about R$600 million-R$700 million and result in FOCF deficits when the company is already highly leveraged. Notably, Azul could struggle to access additional financing following two debt restructurings in the past two years.

Outlook

The positive outlook reflects our expectations that Azul will continue expanding capacity and reporting sound operating performance, with EBITDA growth and slightly positive FOCF. The positive outlook is consistent with debt to EBITDA of 4.5x-5.0x and FFO to debt of about 10% in 2025 and 2026.

Downside scenario

We could revise our outlook to stable if amid exchange rate depreciation and poor economic conditions the business stalls, yields are materially lower, or fuel prices higher than in our base-case scenario, such that leverage remains unsustainable and the company reports persistent FOCF deficits and tighter liquidity.

Upside scenario

We could raise the ratings in the next six to 12 months if Azul registers sound revenue growth and maintains healthy operating performance. This would include EBITDA rising in line with our expectations, such that Azul can attain positive FOCF and maintain some liquidity cushion. An upgrade would also be consistent with S&P Global Ratings-adjusted debt to EBITDA below 5.0x and FFO to debt approaching 10% in the next 12 months.

Company Description

Azul is a Brazilian airline founded in 2008 with a total fleet of 182 operating aircraft as of September 2024. The company is the country's largest airline in terms of domestic departures and cities it serves, with more than 900 daily flights reaching over 150 cities. In addition, Azul wholly owns its loyalty program, Azul Fidelidade, which had over 18 million members as of September 2024. In the nine months as of Sept. 30, 2024, Azul generated revenue of about R$13.9 billion and EBITDA of R$4.1 billion.

Our Base-Case Scenario

Assumptions

- GDP growth in Brazil of 3.1% in 2024, 1.9% in 2025, and 2.1% in 2026.
- Inflation in Brazil of 4.3% in 2024, 4.2% in 2025, and 3.7% in 2026, affecting Azul's local costs, including selling, general, and administrative costs and some costs of goods sold (for instance, salaries).
- Year-end exchange rates of R$6.2 per US$1 in 2024 and about R$5.7 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 ASK growing about 5% in 2024, 10%-12% in 2025, and about 8% in 2026.
- Load factor of 80%-81% for the forecast period.
- West Texas Intermediate crude oil prices of about $77 per barrel in 2024 and $70 in 2025 and 2026.
- Average yields fall 2% in 2024 but improve 1% in 2025.
- Capex of R$1.8 billion in 2024 and about R$2 billion in 2025 and 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-31-2020	Dec-31-2021	Dec-31-2022	Dec-31-2023	Dec-31-2024	Dec-31-2025	Dec-31-2026	Dec-31-2027
(Mil. BRL)	2020a	2021a	2022a	2023a	2024e	2025f	2026f	2027f
Revenue	5,744	9,976	15,948	18,554	19,143	21,274	22,830	24,352
Gross profit	1,333	3,396	4,881	5,770	7,292	8,470	9,208	10,142
EBITDA (reported)	(351)	1,599	3,524	4,065	5,531	6,512	7,107	7,902
Plus: Operating lease adjustment (OLA) rent	--	--	--	--	--	--	--	--
Plus/(less): Other	505	(507)	(846)	616	72	72	72	72
EBITDA	154	1,092	2,678	4,681	5,602	6,584	7,179	7,974
Less: Cash interest paid	(480)	(625)	(1,170)	(1,725)	(3,471)	(3,286)	(3,585)	(3,748)
Less: Cash taxes paid	(0)	--	--	--	--	--	--	(20)
Plus/(less): Other	--	--	--	--	--	--	--	--
Funds from operations (FFO)	(326)	467	1,508	2,956	2,132	3,298	3,594	4,206
EBIT	(1,594)	(320)	879	2,426	3,214	4,024	4,523	5,193
Interest expense	2,374	3,604	4,491	5,240	3,345	3,774	3,636	3,843
Cash flow from operations (CFO)	976	(311)	2,437	3,440	2,064	3,424	4,153	4,829
Capital expenditure (capex)	453	777	1,451	972	1,638	1,800	2,050	2,050
Free operating cash flow (FOCF)	524	(1,087)	986	2,467	425	1,624	2,103	2,779
Dividends	--	--	--	--	--	--	--	--
Share repurchases (reported)	--	16	4	7	--	--	--	--
Discretionary cash flow (DCF)	524	(1,104)	982	2,461	425	1,624	2,103	2,779
Debt (reported)	7,361	10,019	8,636	10,901	15,719	15,208	15,372	15,545
Plus: Lease liabilities debt	12,521	14,891	14,583	15,146	17,439	15,661	17,696	19,121
Plus: Pension and other postretirement debt	--	--	--	--	--	--	--	--
Less: Accessible cash and liquid Investments	--	--	--	--	--	--	--	--
Plus/(less): Other	47	106	378	(128)	--	--	--	--
Debt	19,929	25,015	23,598	25,919	33,157	30,869	33,067	34,666
Equity	(14,149)	(18,333)	(19,008)	(21,328)	(25,823)	(26,284)	(26,825)	(26,694)
FOCF (adjusted for lease capex)	524	(3,283)	(1,951)	312	(3,575)	2,022	(1,897)	(721)
Interest expense (reported)	2,374	3,604	4,491	5,240	3,345	3,774	3,636	3,843
Capex (reported)	453	777	1,451	972	1,638	1,800	2,050	2,050
Cash and short-term investments (reported)	3,157	3,075	668	1,897	2,998	4,917	6,053	6,986
Adjusted ratios								
Debt/EBITDA (x)	129.1	22.9	8.8	5.5	5.9	4.7	4.6	4.3
FFO/debt (%)	(1.6)	1.9	6.4	11.4	6.4	10.7	10.9	12.1
FFO cash interest coverage (x)	0.3	1.7	2.3	2.7	1.6	2.0	2.0	2.1
EBITDA interest coverage (x)	0.1	0.3	0.6	0.9	1.7	1.7	2.0	2.1
CFO/debt (%)	4.9	(1.2)	10.3	13.3	6.2	11.1	12.6	13.9
FOCF/debt (%)	2.6	(4.3)	4.2	9.5	1.3	5.3	6.4	8.0
DCF/debt (%)	2.6	(4.4)	4.2	9.5	1.3	5.3	6.4	8.0

Azul S.A.--Forecast summary

Lease capex-adjusted FOCF/debt (%)	2.6	(13.1)	(8.3)	1.2	(10.8)	6.6	(5.7)	(2.1)
Annual revenue growth (%)	(49.8)	73.7	59.9	16.3	3.2	11.1	7.3	6.7
Gross margin (%)	23.2	34.0	30.6	31.1	38.1	39.8	40.3	41.6
EBITDA margin (%)	2.7	10.9	16.8	25.2	29.3	30.9	31.4	32.7
Return on capital (%)	(17.9)	(5.1)	15.6	52.8	53.9	67.5	83.6	73.1
Return on total assets (%)	(9.1)	(1.9)	4.7	12.4	14.8	18.5	21.2	22.3
EBITDA/cash interest (x)	0.3	1.7	2.3	2.7	1.6	2.0	2.0	2.1
EBIT interest coverage (x)	(0.7)	(0.1)	0.2	0.5	1.0	1.1	1.2	1.4
Debt/debt and equity (%)	344.8	374.4	514.1	564.5	452.1	673.3	529.8	434.9
Debt fixed-charge coverage (x)	0.1	0.3	0.6	0.9	1.6	0.6	2.0	2.1
Debt/debt and undepreciated equity (%)	344.8	374.4	514.1	564.5	452.1	673.3	529.8	434.9

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

Liquidity

Azul's liquidity position is less than adequate, mainly reflecting that we expect limited access to financing before it rebuilds a credit track record following two debt restructurings.

We expect liquidity sources to uses to be comfortably above 1.2x in the next 12 months amid an improved cash position and operating cash flow following the latest debt restructuring. Additionally, there is no single meaningful maturity in the short term. That said, we believe Azul’s standing in credit markets and access to bank financing might be more limited until it shows a track record of improved cash flow.

Principal liquidity sources

- Unrestricted short-term cash of R$1.1 billion as of September 2024.
- Cash FFO after lease payments of about R$1.7 billion in the next 12 months.
- Proceeds from the super priority notes of about R$2.9 billion.

Principal liquidity uses

- Short-term debt of about R$1.4 billion in the next 12 months.
- Working capital needs of about R$130 million in the next 12 months.
- Capex of about R$1.8 billion over the next 12 months.

Covenants

The company has debt acceleration covenants on its domestic debentures that require:

- Debt to EBITDA below 5.5x; and
- Fixed-charge interest coverage greater than 1.2x.

The new super priority notes contemplate a debt incurrence covenant as of July 2025:

- Total leverage ratio (calculated, for the purposes of this paragraph (ix), excluding current and long-term leases--as determined in accordance with International Financial Reporting Standard [IFRS]) is equal to or less than 3.5x .

We expect Azul to comply with these covenants in 2025 and 2026 with at least 20% EBITDA headroom.

Environmental, Social, And Governance

Environmental factors are a negative consideration in our credit rating analysis of Azul. All airlines face long-term risk from tighter greenhouse gas emissions regulation. Azul's fleet has an average age of 7.1 years, which is lower than the global average. Through fleet transformation, it has reduced fuel consumption per ASK and currently operates over 80% of its seats with low-carbon aircraft. However, this might not be enough to offset long-term risks.

Social factors remain a negative consideration since Azul's finances are still suffering from the pandemic-induced economic shock. Azul has undertaken two debt restructurings in the past two years to straighten up its capital structure following debt and liabilities build-up during the pandemic years.

Issue Ratings--Recovery Analysis

Key analytical factors

- Our 'CCC-' issue rating on Azul's 2026 unsecured notes is two notches 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 now have. The super priority notes now rank ahead of all other debt. These new notes add to an already large portion of secured debt that includes the 2028, 2029, and 2030 senior secured 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.
- We use a pro forma capital structure, considering conversion into equity of part of the 2029 and 2030 notes and including the new super-priority notes

Simulated default assumptions

- Simulated year of default: 2026
- We apply an overall haircut of about 59% to Azul's asset base, including a haircut of about 68% to its cash (which already includes proceeds from new financing), 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$5.5 billion.

Simplified waterfall

- Net enterprise value after administrative costs (5%): R$5.3 billion
- First-priority debt at default including six months of accrued interest: R$3.1 billion
- Total secured debt, including priority: R$15.4 billion
- As a result, there's no residual value available to unsecured claims.
- Senior unsecured notes/lease rejected claims at default: R$3.0 billion
- Recovery expectations for unsecured notes due 2026: 0%

Related Criteria

- Criteria | Corporates | General: Sector-Specific Corporate Methodology, April 4, 2024
- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, 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: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, 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		
Upgraded; Outlook Action		
	To	**From**
Azul S.A.		
Issuer Credit Rating	CCC+/Positive/--	SD/--/--
Brazil National Scale	brBB+/Positive/--	SD/--/--
Ratings Affirmed; Recovery Ratings Unchanged		
Azul Investments LLP		
Senior Unsecured	CCC-	
Recovery Rating	6(0%)	