

# MOODY'S

## RATINGS

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

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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 equityization 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.

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