

# MOODY'S

## RATINGS

### **Rating Action: Moody's Ratings downgrades Azul's ratings to Caa2; outlook changed to negative**

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20 Sep 2024

New York, September 20, 2024 -- Moody's Ratings (Moody's) has today downgraded Azul S.A. (Azul)'s corporate family rating (CFR) to Caa2 from Caa1. At the same time, we downgraded to Caa1 from B3 the rating of the senior secured first lien debt and to Caa2 from Caa1 rating of the senior secured debts of Azul Secured Finance LLP (Delaware), and to Caa3 from Caa2 the senior unsecured debt ratings of Azul Investments LLP. The outlook for the issuers was changed to negative from positive.

#### RATINGS RATIONALE

The downgrade of Azul's ratings reflects the weaker results the company posted during 2024 and the resulting cash burn, which heightened liquidity risks. Azul generated BRL1.2 billion in EBIT during the first half of 2024, but high working capital needs, debt burden and capital expenditures led to a cumulative cash burn of BRL1.2 billion in the same period. Azul's cash position declined to BRL1.4 billion at the end of June 2024 from around BRL 1.9 billion at the end of 2023, and the company has BRL5.9 billion in financial and lease obligations coming due in the short term. Accordingly, Azul's liquidity risk have increased, and the company will need to pursue additional renegotiations with lessors and additional financing to bridge its liquidity needs.

Azul's Caa2 corporate family rating (CFR) reflects Azul's exposure to the volatility of the airline industry and rising macroeconomic risks, combined with its still-weak credit metrics. Azul has a highly leveraged balance sheet and weak interest coverage, which limit the company's free cash flow (FCF) generation. The company's ability to raise liquidity, refinance its financial obligations and control cash burn or cash needs will remain key in assessing its rating. Finally, the rating captures the company's intrinsic exposure to foreign-currency and fuel price volatility.

Azul has an unique business position in Brazil (Ba2 positive) as the only carrier on about 80% of its routes, which results in lower competition and strong pricing power. Azul's ability to reduce costs during the pandemic and its conservative financial policies are additional credit positives. The rating also captures the faster-than-

expected post-pandemic recovery in passenger traffic in Brazil, and more rational competition and capacity in the Brazilian market, which has enabled carriers to increase airfares, mitigating the effect of higher jet fuel prices and other inflationary cost pressures.

## LIQUIDITY

As of June 2024, Azul's cash position was BRL1.4 billion, which was enough to cover about 24% of the company's total debt due in the short term (including leases). The company has about BRL5.6 billion of leasing payments scheduled until the end of 2025, in addition to BRL1.8 billion of debt to be repaid through 2025. The company has around BRL1.4 billion in other potential liquidity sources, such as short-term receivables and financeable deposits, in addition to unencumbered assets that could be used in secured financing transactions.

We estimate that Azul's operating cash generation will recover to between BRL3.5 and BRL5 billion in 2024-25, while the company will manage cash outflow by delaying the delivery of aircraft to reduce capital spending and manage cash generation. Nevertheless, the company will still need to refinance its debt maturities to avoid a significant cash burn in the coming years.

## NOTCHING CONSIDERATIONS

The Caa3 rating assigned to Azul Investments LLP's unsecured notes is one notch lower than the company's Caa2 CFR, reflecting the effective subordination of unsecured creditors. The senior unsecured notes rank below Azul's existing and future secured claims, which account for around 95% of the company's debt. Azul's consolidated debt is mainly composed of finance leases collateralized by aircraft, secured notes collateralized by cash flow and receivables generated by Azul Fidelidade and Azul Viagens, and debentures collateralized by credit card receivables.

The exchanged secured notes due 2029 and senior secured notes due 2030 are rated Caa2, in line with Azul's CFR, primarily reflecting the instruments' pool of collaterals, which include a second-priority lien on, among other assets, certain cash flow and receivables generated by Azul Fidelidade and Azul Viagens, and certain intellectual property of the two businesses, and intellectual property of the Azul airline business; and a security on a first-lien basis (subject to future permitted priming debt) by Azul Cargo.

The first priority secured notes due 2028 are rated Caa1, one notch higher than the company's secured ratings, reflecting the instruments' collateral package and protection features, which include first priority lien on, among other assets, certain cash flow and receivables generated by Azul Fidelidade and Azul Viagens, and certain intellectual property of the two businesses, and intellectual property of the Azul airline business; fiduciary assignments and transfers in place to ring-fence the receivables for the noteholder's protection even in a bankruptcy scenario; high

affirmation likelihood of the collateral because of the mission-critical intellectual property required for Azul to continue operations under the airline brand; the intellectual property included in the transaction scope, which will be owned by a bankruptcy-remote offshore special-purpose vehicle; and segregated collection accounts with a protective lockbox structure, whereby cash collections are blocked at all times until enough cash is reserved for debt obligations due on the next payment date.

## RATING OUTLOOK

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.

## FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

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.

## COMPANY PROFILE

Headquartered in Barueri near the City of Sao Paulo, Brazil, Azul S.A. is a Brazilian airline founded by David Neeleman 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 168 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 and Lisbon. Azul is the sole owner of the loyalty program Azul Fidelidade, a strategic revenue-generating asset that has more than 17 million members. In the twelve months ended in June 2024, Azul generated BRL18.7 billion (\$3.4 billion) in net revenue.

The principal methodology used in these ratings was Passenger Airlines published in August 2024 and available at <https://ratings.moodys.com/rmc-documents/426534>. Alternatively, please see the Rating Methodologies page on <https://ratings.moodys.com> for a copy of this methodology.

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Carolina Chimenti  
Vice President - Senior Analyst  
Corporate Finance Group  
JOURNALISTS: 1 212 553 0376  
Client Service: 1 212 553 1653

Marcos Schmidt  
Associate Managing Director  
Corporate Finance Group  
JOURNALISTS: 1 212 553 0376  
Client Service: 1 212 553 1653

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

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