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CREDIT OPINION
30 October 2018

Update

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RATINGS

Azul S.A.

Domicile	Barueri, Sao Paulo, Brazil
Long Term Rating	Ba3
Type	LT Corporate Family Ratings
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Azul S.A.

Update to credit analysis

Summary

Azul S.A.'s (Azul) Ba3 corporate family rating (CFR) reflects the company's unique business position in Brazil (Ba2 stable) as the only carrier in 71% of its routes, resulting in lower competition and strong pricing power. Azul's young and modern fleet, higher margins and less volatile results compared with those of its peers in the Brazilian airline market are additional credit positives. The rating also takes into consideration the company's superior network connectivity and strategic partnerships with global companies, with around 65% of its client base consisting of corporate customers. Additionally, the rating reflects the company's improving capital structure after its IPO, conservative financial policies and adequate liquidity. The rating also incorporates the benefits of its experienced management team, which responded quickly to the slowdown in the Brazilian economy, and the ownership of its TudoAzul loyalty program that contributes a stable source of cash and could be used as an alternative source of liquidity, if needed.

However, the Ba3 rating is constrained by the company's exposure to the Brazilian real and fuel price volatility. Accordingly, 52% of its operating expenses and 68% of its total adjusted debt are denominated in foreign currencies, while fuel accounts for around 28% of operating costs. The rating also incorporates Azul's low geographic diversity with most of its revenue generated in Brazil. A slower-than-expected recovery or reversal in Brazil's economic activity are threats to the company's growth plans, which includes a substantial increase in its higher-capacity A320neo fleet.

Credit strengths

» Unique position as the only carrier in 71% of its routes

» Superior network connectivity and strategic partnerships with global players

» Strong liquidity and improving capital structure

» Experienced management team and conservative policies

Credit challenges

» Exposure to the Brazilian real and fuel price volatility

» Low geographic diversity, with most of its revenue originated in Brazil

» Still high leverage, low interest coverage and near-term maturity pressures

» Slower-than-expected economic recovery, which could threaten growth plans

Rating outlook

The stable outlook reflects our expectation that the company will continue to increase its operating margin, expand its internal cash flow generation and reduce its leverage going forward. The stable outlook also assumes that management will continue to implement its refinancing strategy in a timely manner maintaining its demonstrated conservative profile towards liquidity.

Factors that could lead to an upgrade

Positive pressure on Azul's rating could arise if the company shows a track record of strong operating performance, lower leverage and robust liquidity, while executing its growth plan and expanding its fleet with larger aircraft. These target metrics quantitatively translate into the following: (1) reducing leverage to below 3.0x total adjusted debt to EBITDA (4.3x in the 12 months ended June 2018), (2) increasing interest coverage to at least 5.0x (funds from operations + interest)/interest (2.6x in the 12 months ended June 2018); and (3) maintaining a strong liquidity profile, as illustrated by a cash-to-revenue ratio higher than 20% (18.7% as of the end of June 2018) for a sustained period.

Factors that could lead to a downgrade

The rating could be downgraded if Azul's liquidity is strained because of a prolonged market downturn or continued revenue decline, which — combined with its aircraft acquisition program — would lead to weaker free cash flow generation. Downward pressure on the rating could occur if the company's adjusted EBIT margin declines below 10.0% (16.6% for the 12 months ended June 2018) or its adjusted leverage remains above 5.0x (4.3x in the 12 months ended June 2018) for a sustained period.

Key indicators

Exhibit 1
Azul S.A.

USD Millions	Dec-14	Dec-15	Dec-16	Dec-17	LTM (Jun-18)	Moody's 12-18 Month Forward View
Revenue	2,472.5	1,908.9	1,922.7	2,439.9	2,547.7	$2200 - $2600
EBIT Margin %	12.6%	5.6%	13.4%	19.1%	16.6%	15% - 20%
Debt / EBITDA	7.0x	10.9x	5.3x	4.1x	4.3x	3.7x
RCF / Debt	4.5%	-1.0%	1.9%	11.8%	11.4%	10% - 12.5%
(FFO + Interest Expense) / Interest Expense	1.5x	0.9x	1.2x	2.4x	2.6x	2.4x - 3x

All figures and ratios are calculated using Moody's estimates and standard adjustments.
Source: Moody's Financial Metrics™

Profile

Headquartered in Barueri near the city of Sao Paulo, Brazil, Azul S.A. (Azul) is a Brazilian airline founded by David Neeleman in 2008. The company is the largest airline in Brazil by number of cities and departures, serving 107 destinations with a fleet of 121 aircraft and operates 780 flights daily. Azul is the third largest airline is Brazil in terms of revenue passenger kilometers (RPKs). The company also flies its aircraft to select international destinations, including Fort Lauderdale, Orlando and Lisbon. Azul is the sole owner of the loyalty program TudoAzul, a strategic revenue-generating asset, which had around 9.7 million members as of June 31, 2018. In the 12 months ended June 2018, Azul generated BRL8.4 billion ($2.3 billion) in net revenue and carried more than 22 million passengers.

Detailed credit considerations

Unique position leads to lower competition and stronger pricing power

Since its foundation in 2008, Azul focused on routes previously neglected by the larger existing airlines. The company currently owns the most extensive and unique network in Brazil, offering passengers 780 daily flights to 107 destinations. With a fleet of 121 aircraft and more than 11,000 crew members, the company had a network of 217 non-stop routes as of June 30, 2018.

The company is the only carrier in 71% of its routes and has the largest share in terms of revenue in 81% of them. The lack of significant overlaps with larger competitors, such as Gol Linhas Aereas Inteligentes S.A. (B2 stable), LATAM Airlines Group S.A (Ba3 stable) and Avianca Holdings S.A., allows Azul to charge more for its tickets and even pass through the increase in costs, such as fuel or foreign exchange, more easily than the competition. This advantage is key for maintaining higher and more stable margins, and provides the company with flexibility to work on its own schedule of flights, controlling the capacity that is offered in each segment and time slot.

Azul deploys smaller planes such as the ATRs and E-Jets to bring passengers to its main hubs, Viracopos in Campinas, Confins in Belo Horizonte, and Recife in the northeast, connecting large metropolitan areas to smaller cities, a model that did not exist in Brazil before and, in our opinion, is tough for competitors to replicate.

Passenger demand for air transportation in Latin America, as measured by RPK, has been growing above the global average over the last 10 years, supported by the middle class' income growth, larger credit availability and significant demand shift from ground to air transportation in long-distance travel. However, there has been softer demand growth in the region since 2015, mainly because of weaker macroeconomic conditions and reduced consumer confidence in Brazil, a situation that is slowly improving. According to the International Air Transportation Association (IATA), RPK in Latin America rose 4.4% in August 2018 from a year earlier and Brazil's domestic air travel improved 3.8% in the same period, reflecting some recovery in the country's economic situation.

Azul on the other hand reported strong net revenues of BRL8.46 billion ($2.3 billion) for the 12 months ended June 2018 and BRL2.1 billion in the second quarter of 2018, an increase of 20.5%, mostly because of an increase in passenger traffic (RPK) of 17.4% on a capacity growth of 18.6%, representing a load factor of 80.1%, 0.8 percentage points lower than in Q2 2017. Passenger revenue per ASK (PRASK) increased 1.1% in Q2 2018 from the year-earlier period as a result of the increase in load factor. These results are supported by Azul's differentiated business model and the pent-up demand in its target markets.

Strategic partnerships with global players and international flights

Azul has built strategic partnerships with strong global players, generating value through codeshare agreements, loyalty cooperation, fleet management and pilot staffing. These agreements help capture connecting passengers into Azul's network, cross-selling flights, increasing passenger flow between regions and increasing opportunities for TudoAzul members to accrue and redeem points.

The main partnership was celebrated with United Airlines, that made a $100 million capital injection in Azul in June 2015 for a 5% stake. In September 2015, the two companies signed a codeshare agreement and are currently in discussions to establish a joint venture. In February 2016, HNA Group made a $450 million investment in Azul for a 24% economic interest in the company, of which $350 million was capitalized and $100 million was invested in the acquisition of €90 million in TAP's convertible bonds. If converted, the notes will represent an almost 42% economic interest in the Portuguese company. The HNA Group sold its entire stake in Azul during 2018. HNA has been selling overseas real estate and some of its biggest financial and strategic investments following important acquisitions that added to around $50 billion over the past two years.

Since the beginning of Azul's operations, TAP has been responsible for the maintenance of Azul's Embraer E-jets and its A330's. After the acquisition of TAP's bonds, the two airlines established a codeshare agreement to explore flights between Brazil and Portugal, as well as connections throughout Europe.

Azul also operates flights from its main hubs in Brazil to Lisbon, Orlando, and Fort Lauderdale, taking advantage of the high number of Brazilian passengers flying to these destinations or connecting to other parts of Europe and the US. To operate in these routes, Azul has six A330 aircraft.

Strategic partnerships with other airlines also helped the company in reducing capacity during the economic slowdown in Brazil.

Experienced management team and conservative policies

Azul has a seasoned management team with many years of experience in the airline industry, which has responded quickly to the economic slowdown in Brazil and has established conservative financial policies and corporate governance standards. The company's management took advantage of its expertise acquired with JetBlue's E-Jets and, with the acquisition of TRIP, gained the know-how of the world's largest ATR aircraft operator.

Neeleman, a dual Brazilian and US citizen, is Azul's founder and the chairman of its board of directors. Before Azul, Mr. Neeleman founded JetBlue, where he held the position of chief executive officer from 1998 to 2007 and chairman of the board of directors from 2002 to 2008. Neeleman's career in the airline industry began in 1984, when he co-founded Morris Air. Neeleman was also co-founder of WestJet Airlines and served as a member of its board of directors from 1996 to 1999. Neeleman is also part of a consortium that acquired an equity interest in TAP through TAP's privatization process in 2015 and is currently a member of the board of directors of TAP.

John Rodgerson is Azul's chief executive officer. Before Rodgerson held the position, he was Azul's chief financial officer and investor relations officer, and was responsible for the planning and financial analysis, treasury and accounting departments. Rodgerson worked on Azul's initial business plan with Neeleman and was part of the founding team. Before joining Azul, Rodgerson served as director of planning and financial analysis at JetBlue from 2003 to 2008.

Exposure to foreign currency and fuel volatility

Azul uses the Brazilian real as its functional currency for the pricing of most of its products, while a significant part of its costs and debt are denominated in US dollars, creating a mismatch between revenue, costs and liabilities that can negatively affect its operating results, leverage and other credit metrics.

In the H1 2018, 52% of Azul's operating expenses and 80% of its total adjusted debt were denominated in foreign currencies. At the same time, fuel accounted for around 28% of its operating costs, while only around 16% of the company's revenue was denominated in hard currencies. As a mitigating factor, the company has BRL5.6 billion in assets denominated in foreign currencies, including cash in US dollars, cash deposits and maintenance reserves, TAP's bonds in euros and its aircraft fleet denominated in US dollars, covering 4.6x the company's liabilities in US dollars. It is the company's strategy to have between 50% and 100% of coverage exposure of non-operational US dollar flows for the next 12 months.

Azul's fuel-hedging strategy comprises derivatives with financial institutions and fixed-price contracts with its main supplier, Petrobras. The objective is to fix the price of up to 50% of its fuel consumption for the first quarter out, 35% for the second quarter, 25% for the third quarter and 15% for the fourth quarter. As of June 30, 2018, Azul had locked in fuel contracts for around 15% of its next 12 months' consumption through derivative financial instruments and fixed-price contracts with its main supplier.

Leverage is still high

Azul's debt is mainly composed of local market debentures (16.1%), finance leases (28.9%), aircraft financing (9.1%) and working capital loans (45.9%), totaling BRL3.8 billion as of the end of June 2018. Moody's-adjusted total debt although considers operating leases as part of the adjusted debt, adding BRL6.9 billion to the total, corresponding to 5x the last-12-month rent expenses, which increases the company's total adjusted debt to EBITDA to 4.3x in the 12 months ended June 2018. As of the end of Q2 2018, Azul's total debt had an average maturity of only 4.1 years and an average interest of 6.7% for its local debt and 5.0% for its US dollar-denominated obligations. Around 68% of Azul's total debt and 99% of its non-aircraft debt was denominated in BRL.

Compared with Q1 2018, total debt increased by BRL446.9 million, mostly because of the depreciation of the Brazilian real, partly offset by hedges on the senior notes, with a fair value of BRL222.2 million in the end of the Q2 2018. As part of the company's efforts to improve its liquidity and lower financial expenses, Azul intends to continue optimizing its debt position over the course of the second half of the year. Additionally, we expect the company to continue amortizing its debt with its internal cash generation and to keep issuing cheaper, longer-term debt in the financial markets, bringing down leverage. Accordingly, we estimate adjusted leverage will approach 3.7 times in 2019.

Despite the still-high leverage, Azul's credit profile has been improving since 2014, a result of a combination of enhancements in financial performance and debt repayments. These improvements were possible because of the capital injection from its partner airlines that raised $550 million and the IPO in April 2017, with another BRL1.2 billion in net proceeds. Profitability should further improve, taking advantage of the company's executed reduction in capacity, combined with some economic recovery, additional ancillary revenue, more efficient fleet and its unique network.

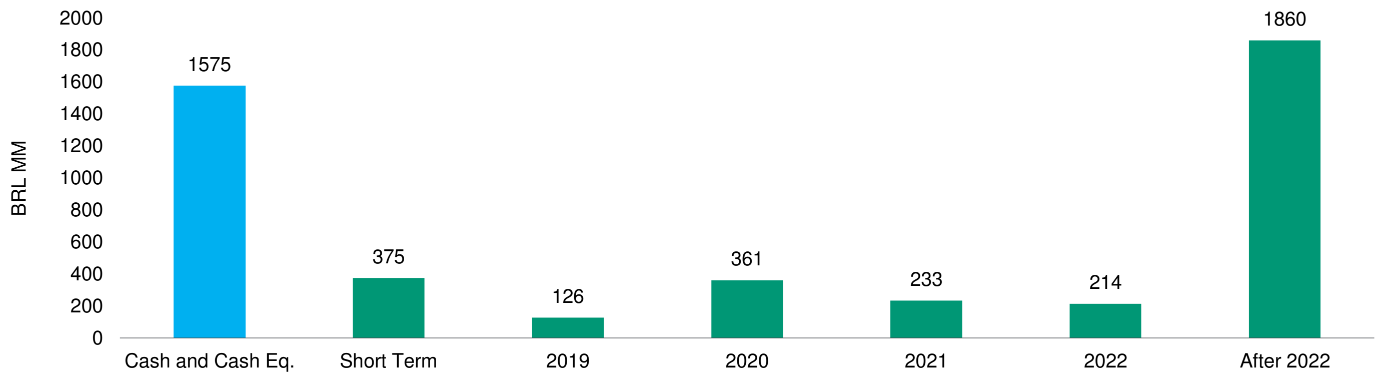
Liquidity analysis

As of the end of June 2018, Azul's cash position was BRL1.6 billion, or 18.7% of last-12-month revenue, which was enough to cover 2.9x the company's current portion of long-term debt. Azul is targeting a minimum cash availability of 15% of its last-12-month net revenue and does not have committed facilities. Azul's long-term investments in TAP's bonds (worth around BRL1.1 billion), accounts receivables in the order of BRL1.2 billion and its investment in its wholly owned subsidiary TudoAzul could be used as alternative sources of liquidity, if needed.

Exhibit 2

Maturity profile

As of June 2018 (BRL Million)



Source: Moody's Financial Metrics™

Structural considerations

The B1 rating assigned for Azul's unsecured notes is one notch lower than the company's Ba3 CFR to reflect the effective subordination of those unsecured creditors to the company's other existing secured debt. Azul's consolidated debt pro forma for the proposed bond issuance will be mainly composed of finance leases collateralized by aircraft, representing about 50% of its total debt, and the other 50% will be comprised of the proposed unsecured bonds and other unsecured debt. As such, the proposed unsecured notes will rank below all the company's existing and future secured claims.

Corporate governance

Since the execution of its IPO at the end of April 2017, Azul is listed on B3 (formerly BM&FBovespa) under level 2 of the corporate governance standards that demands a minimum 25% free float, 100% tag along rights to minority shareholders, voting rights to preferred shareholders in certain circumstances and minimum number of independent directors, among others. Azul's board of directors is comprised of 11 members, of which nine are independent. The company also has an established audit committee.

Neeleman is Azul's largest controlling shareholder with 67% of voting shares, the balance is owned by TRIP's former shareholders. United Airlines is the largest preferred shareholder with 8.3%, followed by TRIP's former shareholders with 7.7% and Neeleman at 3%, among others. Free float is around 80.9%.

The management team is composed of professionals, most of them with many years of experience in the airline industry and Azul.

Methodology and scorecard

The grid-implied rating from our 12-18-month forward view under the Global Passenger Airlines rating methodology is Ba3, which is Azul's current CFR. The rating reflects the execution risks involved in the company's growth strategy, track record in deleveraging while maintaining strong liquidity on its balance sheet and risks outside the company's control including, but not limited to, uncertainties in the Brazilian economy, and foreign exchange and fuel volatility.

Exhibit 3

Rating factors

Azul S.A.

Passenger Airlines Industry Grid [1][2]	Current LTM 6/30/2018		Moody's 12-18 Month Forward View As of 10/5/2018 [3]	
Factor 1 : Scale (10%)	**Measure**	**Score**	**Measure**	**Score**
a) Revenue (USD Billion)	$2.5	Caa	$2.2 - $2.6	Caa
Factor 2 : Business Profile (25%)				
a) Market Position and Network Strength	Ba	Ba	Ba	Ba
Factor 3 : Profitability and Efficiency (12.5%)				
a) EBIT Margin (EBIT / Revenue)	16.6%	Baa	15% - 20%	Baa
Factor 4 : Leverage and Coverage (37.5%)				
a) Debt / EBITDA	4.3x	Ba	3.7x	Ba
b) RCF / Debt	11.4%	B	10% - 12.5%	B
c) (FFO + Interest Expense) / Interest Expense	2.6x	B	2.4x - 3x	B
Factor 5 : Financial Policy (15%)				
a) Financial Policy	Ba	Ba	Ba	Ba
Rating:				
a) Indicated Outcome from Scorecard		Ba3		Ba3
b) Actual Rating Assigned				Ba3

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
[2] As of 6/30/2018(L).
[3] This represents Moody's forward view, not the view of the issuer, and unless noted in the text, does not incorporate significant acquisitions and divestitures.
Source: Moody's Financial Metrics™

Ratings

Exhibit 4

Category	Moody's Rating
AZUL S.A.	
Outlook	Stable
Corporate Family Rating	Ba3
AZUL INVESTMENTS LLP	
Outlook	No Outlook
Bkd Senior Unsecured	B1

Source: Moody's Investors Service

Appendix

Exhibit 5

Peer comparison

	Azul S.A. Ba3 Stable			Delta Air Lines, Inc. Baa3 Stable			Deutsche Lufthansa Aktienges Baa3 Stable			Gol Linhas Aereas Inteligent B2 Stable			LATAM Airlines Group S.A (LA Ba3 Stable		
(in USD millions)	FYE Dec-16	FYE Dec-17	LTM Jun-18	FYE Dec-16	FYE Dec-17	LTM Jun-18	FYE Dec-16	FYE Dec-17	LTM Jun-18	FYE Dec-16	FYE Dec-17	LTM Jun-18	FYE Dec-16	FYE Dec-17	LTM Jun-18
Revenue	$1,923	$2,440	$2,548	$39,639	$41,244	$43,139	$35,031	$40,200	$42,429	$2,844	$3,313	$3,370	$8,988	$9,614	$9,979
Operating Profit	$196	$376	$290	$7,605	$6,529	$6,000	$1,980	$3,306	$3,484	$320	$397	$465	$760	$863	$872
EBITDA	$578	$805	$752	$10,477	$9,607	$9,245	$4,432	$5,971	$6,400	$685	$842	$922	$2,104	$2,358	$2,373
Total Debt	$3,257	$3,151	$2,807	$26,998	$27,071	$28,019	$18,472	$17,506	$16,811	$3,616	$3,665	$3,396	$11,450	$10,789	$10,401
Cash & Cash Equiv.	$169	$230	$221	$2,762	$1,814	$1,886	$4,153	$4,741	$4,792	$305	$598	$460	$1,651	$1,640	$1,212
EBIT / Int. Exp.	0.8x	1.7x	1.8x	5.9x	5.1x	5.0x	3.3x	4.9x	6.2x	0.9x	1.2x	1.4x	1.3x	1.7x	1.8x
Debt / EBITDA	5.3x	4.1x	4.3x	2.6x	2.8x	3.0x	4.4x	2.8x	2.7x	5.0x	4.5x	4.3x	5.4x	4.6x	4.4x
RCF / Net Debt	2.1%	12.7%	12.3%	31.4%	18.4%	27.3%	22.2%	36.2%	36.1%	7.2%	8.4%	13.1%	9.4%	13.7%	12.6%
FCF / Debt	-3.7%	-3.3%	-3.0%	17.1%	15.1%	10.0%	2.7%	8.6%	2.3%	-5.9%	3.2%	3.5%	-2.0%	6.8%	5.8%

All figures and ratios calculated using Moody's estimates and standard adjustments.
Source: Moody's Investors Service

Exhibit 6

Moody's-adjusted debt breakdown

(in USD Millions)	FYE Dec-14	FYE Dec-15	FYE Dec-16	FYE Dec-17	LTM Ending Jun-18
As Reported Debt	**1,327.6**	**1,299.7**	**1,253.3**	**1,052.1**	**996.7**
Operating Leases	1,950.4	1,905.8	2,003.3	2,099.3	1,809.9
Moody's-Adjusted Debt	**3,278.0**	**3,205.5**	**3,256.6**	**3,151.4**	**2,806.6**

All figures and ratios calculated using Moody's estimates and standard adjustments.
Source: Moody's Investors Service

Exhibit 7

Moody's-adjusted EBITDA breakdown

(in USD Millions)	FYE Dec-14	FYE Dec-15	FYE Dec-16	FYE Dec-17	LTM Ending Jun-18
As Reported EBITDA	**243.0**	**-52.9**	**302.7**	**445.3**	**475.0**
Operating Leases	254.1	327.5	329.9	349.1	337.0
Unusual	29.8	81.5	-54.9	10.1	-60.5
Moody's-Adjusted EBITDA	**526.9**	**356.0**	**577.7**	**804.5**	**751.5**

All figures and ratios calculated using Moody's estimates and standard adjustments.
Source: Moody's Investors Service

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