

Q2 2019 Earnings Call

Company Participants

- Abhi Manoj Shah, Chief Revenue Officer
- Alex Malfitani, Chief Financial Officer
- David Gary Neeleman, Chairman
- John Peter Rodgerson, Chief Executive Officer

Other Participants

- Daniel Mckenzie, Analyst
- Lucas Barbosa, Analyst
- Marcos Barreto, Analyst
- Michael Linenberg, Analyst
- Rogerio Araujo, Analyst
- Savanthi Syth, Analyst
- Savi Syth, Analyst
- Unidentified Participant

Presentation

Operator

Hello, everyone, and welcome to Azul's Second Quarter 2019 Results Conference Call. My name is Paula, and I'll be your operator for today. This event is being recorded and all participants will be in a listen-only mode until we conduct the question-and answer-session following the company's presentation. (Operator Instructions)

I would like to turn the presentation over to Andrea Bottcher, Investor Relations Manager. Please proceed.

Alex Malfitani

Thank you, Paula and welcome all to Azul's second quarter earnings call. The results that we announced this morning, the audio of this call, and the slides that we'll reference are available on our IR website. Presenting today will be David Neeleman, Azul's Founder and Chairman and John Rodgerson, CEO. Alex Malfitani, our CFO and Abhi Shah, our Chief Revenue Officer are also here for the Q&A session.

Before I turn the call over to David, I'd like to caution you regarding our forward-looking statements. Any matters discussed today that are not historical facts, particularly comments regarding the Company's future plans, objectives, and expected performance,

constitute forward-looking statements. These statements are based on a range of assumptions that the Company believes are reasonable, but are subject to uncertainties and risks that are discussed in detail in our CVM and SEC filings.

Also, during the course of the call, we will discuss non-IFRS performance measures, which should not be considered in isolation and are discussed in details in our earnings release.

With that, I'll turn the call over to David. David?

David Gary Neeleman {BIO 687871 <GO>}

Great. Thanks, Andrea. Welcome, everyone, and thanks for joining us for our second quarter 2019 earnings call. As always, I would like to start by thanking our crew members for taking care of our customers on almost 900 daily flights. Thanks to their efforts, we have achieved record second quarter results in what is seasonally the weakest quarter of the year. We continue to strengthen Brazil's largest network and since Q2 of last year, we have added 10 new destinations. We see many more opportunities to grow our network and plan to open six to eight new cities every year.

Our focus is to grow in markets where we are strong. We are the only carrier in 72% of the routes we serve and in the second quarter, we are the leader in terms of departures in an astounding 85% of our markets. We ended the quarter with 29 next-generation aircraft, the largest fleet of fuel-efficient aircraft in South America, representing 39% of our ASKs. We are very happy with the performance of the A320 and could not be more excited about the introduction of the E2 starting in October. The E2s are truly a game changer. At the end of the year, our 46 next-generation aircraft, including six E2s will represent 55% of our December ASKs, giving us great momentum going into 2020.

We have also demonstrated our ability to grow while maintaining operational excellence and great customer service. In June, Skytrax awarded us for the ninth time in a row the Best Regional Airline in South America, also the Best Staff in South America, a strong testament to our great customer service and management team. In fact, our NPS score is one of the highest in the world at above 60 and this compares with some of the best brands in the world.

As you see on Slide 4, we have a ways to go in our margin expansion story. As I just mentioned, we will start replacing E1s with E2s in October, and I couldn't be more excited with the impact these planes will have on our profitability. John will talk about this in more detail in his presentation. We have a regional growth plan that is centered on the transformation of our fleet. By updating our fleet, we will drive down costs, resulting in higher margins. The best news is that we are less than halfway throughout this process.

TudoAzul and Azul Cargo have grown significantly over the past few years, but we are only 50% on the way to our target. The area I'm most excited about is the tremendous growth we are seeing in our e-commerce business. We are uniquely positioned to take advantage at this high margin business. We fly to 114 cities and through our partnerships we are able to reach more than 3,700 municipalities overnight. No other airline or logistics

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company in Brazil has this type of reach. The growth in e-commerce in this country is just getting started and we are the best positioned company to take advantage of it. Very exciting stuff.

In summary, we are on track to deliver on our promise to expand margins by 5 margin points between 2017 and 2020, even though we have faced a much tougher macro environment. On Slide 5, we show that our fleet transformation plan is consistent with our network. By the end of the year, we will have -- as I mentioned, we'll have 46 next-generation aircraft, mostly flying throughout where we are either the only carrier or airports where we have a leadership position. As you can see in the graph, our dominant position continues to increase as we add a more next-generation aircraft.

We are confident about the future of the Brazilian aviation market and our ability to continue expanding margins all the while creating the best experience for our crewmembers and customers. Azul is not only getting bigger, but we are getting better in every way. Because of all the above, I have not sold any of my Azul stock. I believe the best is yet to come. And with that, I'll pass the word over to John to give you more details on the second quarter results.

John Peter Rodgerson {BIO 17734009 <GO>}

Thanks, David. I also want to thank our crewmembers for all their hard work during the past quarter. Thanks to them, we delivered great results. As you can see on Slide 6, we grew capacity by 16% in the second quarter, while expanding our top line revenue by 31% to BRL2.6 billion. In addition to the double-digit growth in capacity, RASK increased 13.6%. Adjusting for the increase in stage length, RASK was up 15.1% year-over-year. This is the third year in a row that we increase capacity by double-digits while increasing RASK. Operating income was a record BRL340 million, up 70% year-over-year. In the second quarter, we received four A320neos and one A330 neo. These aircraft provide significantly lower unit costs through more efficient fuel burn, lower ownership costs and provide more revenues per flight. The second quarter disallowed us to offset cost pressures from higher fuel prices, the devaluation of the Brazilian real and the end of the payroll tax relief program. We made significant investments in the quarter to be ready for the second half of the year, not only by adding new aircraft but also by hiring and training pilots and flight attendants.

Moving on to Slide 7, as you can see, fuel and currency had a negative impact of BRL133 million on our second quarter operating results or approximately 5 margin points. We also had 2 margin points of negative impact from the end of the payroll tax relief program. Thanks to our margin expansion strategy, our ability to recapture revenue and reduce costs, we recovered 160% of this impact reaching the operating margin of 13% and what is seasonally the weakest quarter of the year.

Moving on to slide 8, TudoAzul maintained a strong growth pace during the second quarter with gross billings up 31% year-over-year. This is TudoAzul's fourth consecutive year with over 30% growth. On the right side of the slide, you can see that our cargo business also performed extremely well. Revenue increased 47% year-over-year, benefiting from the expansion of our network and fleet.

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On Slide 7, you can see the extensive outreach of our cargo network. As David mentioned, more than 100 airports they enter our cargo and we have 240 stores nationwide serving 3700 municipalities. We also -- we offer door to our deliveries through our franchisee model. This is a business with higher margins than our -- then our passenger transportation business that requires very little additional investment. We have a diversified customer base, including retailers, manufacturers and online companies in Brazil, who value our reliable and far-reaching logistics solution. E-commerce grew 314% year-over-year, by the far the fastest growing segment in our cargo business.

Moving on to Slide 10, I'm proud to report that we ended the quarter with a very strong liquidity position representing 42% of our last 12 months revenue and this is after growing total revenue by 31% year-over-year. Our balance sheet is further protected against currency fluctuation through assets such as our security deposits and maintenance reserves, totaling an additional 1.5 billion, which are not included in our cash balance.

On the right-hand side of the slide, we show an evolution of our leverage, which reached 3.1 times in June. With the new accounting standard IFRS 16, when a new aircraft arrives we immediately see an increase in debt on the balance sheet reflecting the full term of the lease but we do not yet see the earnings production. Adjusting for these five aircraft that we added during the quarter, our leverage would have been below three. We expected timing effect to level off as these aircraft become fully productive.

On Slide 7, you can see that in addition to the improvement of our operating results in reduction, in leverage, our operating cash flow was over BRL1 billion in the quarter and we generated free cash flow of BRL387 million.

On Slide 12, we present our updated 2019 outlook. We expect to grow our total ASKs between 20% and 22%, with most of this growth coming in the domestic market. Our domestic capacity growth is low risk and focus on strengthening our existing network by replacing smaller aircraft with larger aircraft on routes we already serve. As you know, we made an attempt to acquire part of Avianca Brasil, which included some slots aircraft and employees.

As you are aware, other events happened, but we were able to acquire all 12 of their A320neo and are currently hiring many of their pilots and flight attendants. This investment has put some short-term pressure on our cost as we prepare to induct all of these aircraft into our fleet. As you know the Congonhas slot process is not yet complete. However, we already received 40% of the slots and secured all of their next generation neos, hired many of their pilots and flight attendants and preserved capital in the process. With the addition of these plants, we will end the year with approximately 55% of our capacity coming from next-generation aircraft, truly setting us up for a great 2020.

On the cost side, we expect cap to remain flat but slightly up in 2019, mostly due to the investments we're making for our future growth and so, macro headwinds that we've been facing since, we released our original guidance in the beginning of the year. As we enter the second half of the year, which is seasonally the strongest, we feel confident about our guidance of 18% to 20%.

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Moving on to Slide 13. Looking ahead, we are very excited about the first deliveries of our E2s that we put in the operation in October and the margin expansion opportunities they provide. Looking at the chart, you'll see over 500 of our 870 daily flights are still flown by E1s. In the future, all of them will be flown by E2s, resulting in 14% lower trip cost in over 10% more revenue on each flight. We couldn't be more excited about these planes and the margin contribution they will bring. We look forward to the coming years when we can replace all of our E1s for E2s. We're working very hard to accelerate this process.

In summary, we feel confident about the opportunities that lie ahead of us. We're executing on our fleet transformation plan, our cargo and loyalty businesses are performing incredibly well and we have upside in our investment in TAP important asset with further upside potential. Everything we have accomplished since our IPO has been done in an environment of a weakening real and low economic activity. Imagine what happens when the Brazil engine starts moving again.

Before we open for questions, I would like to invite all of you to join us at our university in Campinas on October 14 for our second Azul Day. This is a great opportunity to meet with our management team, tour our facilities and we'll have an E2 available, so each of you can get to know that unbelievably great product we'll be taking on this year.

With that, David, Alex, and I are available to take your questions.

Questions And Answers

Operator

(Operator Instructions) Our first question comes from Savanthi Syth, Raymond James.

Q - Savanthi Syth {BIO 17476219 <GO>}

Thanks. Good afternoon. Maybe, Abhi, as usual starting off if you could talk a little bit about the domestic versus international trends, especially international seems to be bottoming and improving and I'm kind of curious as the slowing of the international capacity growth is still the kind of right decision or if you're making some adjustments there?

A - Abhi Manoj Shah {BIO 18968426 <GO>}

Yeah, hey, Savi, Abhi here. So, yeah, you're right. You've heard this sentiment from other operators in the region as well talking about improving trends in the Latin, Copa yesterday, United as well. So, yes, we have seen international revenues turn to the positive in second quarter. The Brazil, US markets has capacity down for the rest of the year in the low teens, negative capacity which is very promising. And so the dollar as well, it's well run up recently, but it was -- has stabilized. And so our international trends have definitely improved. The capacity situation has improved as well. And so I think we are definitely seeing positive unit revenues. We expect to see that for the end of the year as well for International.

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We're not changing our plans for international. It's very low risk. It's not adventure, if at all. I have no new destinations planned this year, maybe only spring or summer next year. It's just in the frequencies potentially connecting one dot with another dot, very, very late in the year, but very, very low risk, just being very strong where we are in Brazil, with Orlando, Fort Lauderdale, and Portugal. Argentina continues to struggle a little bit, but we have very low exposure there, only two daily flights basically. So, it's not really a concern. So, yes, it has gotten better. Unit revenues have turned to the positive which is a very good sign. Our capacity discipline continues to be good, but no changes on our side in terms of capacity for instance.

Q - Savanthi Syth {BIO 17476219 <GO>}

Thanks, Abhi. And, Alex, if I might ask, could you provide an update of pilot training costs and kind of how that's progressing and what that shape will be and when the growth might start to show up and kind of scale benefits on the cost side?

A - Alex Malfitani

Yeah, I think we've always talked about the fact that this fleet transformation process does carry some startup costs. Even before we took these Avianca aircraft, we have about a point of margin when you consider the fact that especially pilots but also flight attendants, they are getting paid their salaries, but they're not producing ASKs, plus there is all the cost involved in the training itself. We do a lot of the training in our own university, but we also have to outsource some of this, which includes travel and the cost of the flight hours, the simulator hours in other facilities. So that's about a margin point.

But then, one of the reasons why we wanted to acquire Avianca Brasil was that we were going to get pre-trained pilots. So they would come in and they would continue operating the certificate of the original airline. Once they move from Avianca to Azul, we have the requirement to train them on our operating certificate. So there is an additional maybe half a point of margin this year beyond what we usually have for the fleet transformation. There is about a point and a half this quarter of training, travel, and unproductive time in costs in our P&L.

Q - Savanthi Syth {BIO 17476219 <GO>}

And when does that wind down, Alex? When does we get enough of -- large enough fleet that some of these headwinds start to go away?

A - Alex Malfitani

Avianca specific cost probably in Q4 goes away. The 1 margin point wind down -- as the Company gets bigger, it becomes less of an impact, but it kind of gradually decreases together with our fleet transformation. So as we approach 100% of our fleet getting to next Jan, you will start to see that cost getting less and less material.

A - John Peter Rodgers {BIO 17734009 <GO>}

This is John. One thing that obviously when you go from E1 to E2, it's a two-day difference in training. So it's not the same thing. So it's going to -- as we approach 100%, certainly it'll

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still be there, but it's going to give a lot because as Alex said, we get bigger, but the training as we transform take out 63 E1s and putting 63 E2s, it's minimal pilot...

A - Alex Malfitani

Right. Just E1s and neos, A320neos.

A - John Peter Rodgerson {BIO 17734009 <GO>}

And those are going down and the E2s are accelerating.

Q - Savanthi Syth {BIO 17476219 <GO>}

That makes sense. Thank you.

A - Alex Malfitani

Thank you.

Operator

The next question comes from Michael Linenberg, Deutsche bank.

Q - Michael Linenberg {BIO 1504009 <GO>}

Hey, everyone. Good morning. I guess, two questions here. So if we look at the Congonhas situation, I think you had 26 slots currently and then you've got 15 through this distribution or redistribution. So, now you're at 41 total. Is that a sufficient number, call it 20, 20.5 round trips to participate in the Congonhas Santos demand shuttle? And then can you clarify, there was a press report -- there was something out saying that maybe you would work with one of the other smaller operators and join slots. So kind of a two part question. And then I have one more. Thanks.

A - John Peter Rodgerson {BIO 17734009 <GO>}

Hey, Mike, the process isn't over yet, and that's why we're not announcing what we're going to do with the additional slots. It's still a very concentrated airport, still roughly 94% of the flights are concentrated with the duopoly, and so we're going to continue to kind of push to increase capacity at that airport. The process should be over this week, but there is some smaller operators that ask for slots in the main runway. All things indicate that they will have to move to the auxiliary runway because the operations don't allow for them. It's the landing field that's needed. And so I think you'll probably hear from us over the next week or so and determine what we're going to do with the slots that we received. And so we're continuing to kind of force the issue with the government. We think that airport should be opened out.

We think that every airport in Brazil should be opened up. That airport today is significantly less than capacity when it was 10 years ago. And everything indicates that they can take more operations per hour, and that would kind of help increase competition. And so, we look forward to doing that over the next couple of years, but certainly getting some slots

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there is important. It's a high profile airport. We don't talk a lot about Congonhas at the airline today because, as you indicated, 20 flights, we fly almost 900 flights a day and so we don't want to overplay what Congonhas means, but any opportunity we can to kind of get into that airport, we're going to do it.

Q - Michael Linenberg {BIO 1504009 <GO>}

Hey, John, just -- you talked about the auxiliary runway and I know that as part of this redistribution, I do believe that there were some new slots created by ANAC for one of the carriers to actually give some service on the auxiliary runway. Are you suggesting, though, that maybe some of the other carriers rather than using some of those slots that they could just add more service to the auxiliary runway and then maybe freeing up more slots for everybody else? Is that -- did I hear you right on that?

A - John Peter Rodgerson {BIO 17734009 <GO>}

Yeah. So to the (inaudible) and the ANAC and the local authorities basically said that the ATR operators need to be able to land at 120 knots and ATR doesn't allow you to land at 120 knots and so I think that it's still TBD. And so a lot of work being done with the agencies and we're kind of standing by to see what happens. But certainly there is a possibility Mike that those ATR operators move to the auxiliary runway which is very beneficial overall for the consumer, right? Because it actually allows for more distribution on the main runway, it allows for more carriers to be at that airport. We're not against (inaudible) getting into that airport. We think it's great overall, but I think we want to use the most efficient use of the asset possible, which is using the main runway to fly larger aircraft.

Q - Michael Linenberg {BIO 1504009 <GO>}

Yeah, that would be a fantastic development, certainly a win for the consumers, so hopefully the government goes that way. Just one for you, John. This is second question. It's great that now you're up on the board with the public rating double B-minus. Is there any sort of aspiration to get to an investment grade rating. I mean you're only a few notches away, there is probably only half a dozen airlines in the world that are at that level, but those who are at that level, there are a lot of interesting things that they can do. So you're off to a good start. I know that you probably don't think that it's absolutely essential, but is there maybe internally a drive to get to an investment-grade rating? That would be pretty impressive for a carrier based down in South America to have that. Thank you.

A - John Peter Rodgerson {BIO 17734009 <GO>}

You know, Mike, I'll let Alex answer the question, but we're extremely competitive people and anytime we can get our ratings up, it's something we want to do, but I'll let Alex --.

A - Alex Malfitani

Yeah. I think that's exactly right. It's a little bit of when we started talking about expanding margins by 5 margin points. Once people started seeing that we were on track to deliver they started to ask, okay, so what's next? And obviously, we're not going to just retire. We're going to continue pushing for higher margins to get the company bigger, more

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valuable and the same thing applies to leverage, the same thing applies to our rating. We have brought leverage to a low 3. I think if you do the math correctly, we're in the high-2s and our margin expansion plan will allow us to continue reducing this to mid-2s, low-2s then we'll see once we get there what we do, but I think we won't rest and whenever we get to the target, we'll just see that sort of just the stepping stone for the next target that we're going to try to achieve. And we believe very strongly at the best of Azul is yet to come, both on a margin basis leverage ratings and so we're just going to continue working in that direction.

Q - Michael Linenberg {BIO 1504009 <GO>}

Okay, great. Thanks, Alex.

A - Alex Malfitani

Thanks, Mike.

Operator

The next question comes from Rogerio Araujo, UBS.

Q - Rogerio Araujo {BIO 17308156 <GO>}

Hi guys, good afternoon. Thanks for the opportunity. I have a couple of questions. So first, what is the order price considered in the new guidance? Is there any upside from this recent drop in the past days? That's the first question. Thank you.

A - John Peter Rodgerson {BIO 17734009 <GO>}

Sure. John. So our philosophy with guidance is we update our forecast at least once a month if not more often than that as required. When we do that we look at the forward curve for heating oil and we look at the Focus survey for the dollar real exchange rate. And then, so we did that, a while ago when we closed the books on Q2. Since then the real has moved down but oil has also moved down. As long as our expected mid-point of our guidance is within the range that we've put out, we don't change the guidance. And so it is fair to say that since we did the math and we closed the books on Q2, the dollar went up and oil went down. I think it's roughly a wash since then.

So, there is some bad guy from FX, but there is a good guy from oil, but in the end, I don't think it's much different from what we originally set out, which was a few weeks ago looking at the forward curve and focus survey -- and the focus survey, we were actually put in a little bit of conservatism, because I think there is a lot of optimism in the FX rate from the focus survey, so we're a little bit more conservative than that. We don't exactly give out that number, but that's roughly sort of the philosophy of what we do with guidance. I think the current prices reflect roughly what we had when we closed the books and saw that we were going to reaffirm our EBIT margin guidance for the year.

Q - Michael Linenberg {BIO 1504009 <GO>}

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Thanks, John. Very clear. So second question is on the CapEx expansion implied in the fleet plan. So there is almost 20% seat capacity expansion now in the second half of this year. So, I would like to know if you could provide me a little bit more color on the markets. This capacity should be deployed or even in the airports, if Guarulhos there as it has been increasing capacity, is one of the targets and what you expect in terms of any change in knowing in the focus for routes that are more regional or it's going to be the same focus. So, a little bit more color on that would be great. Thank you.

A - Alex Malfitani

Yeah, Alex here. Sure, I can actually give you more color on that. So I'll give you some examples here. We'll give you an idea on how we're focusing on capacity. First of all, as David and John both said, we expect to end the year with 70% to 71% of our routes alone and that's the number that we started the year with. So when all things considered at the end of the day, that dominant position we have will not change, and that's an indication of where our focus is on the network side. But I'll give you some examples here. We currently fly 226 non-stop routes roughly. Our 24 then are new. We hadn't this year, we didn't have them last year. Of these, only 5 of the 24, our former Avianca markets, only 3 of the 24 are in Guarulhos. So that gives you an example of all of the places we've added new routes and we haven't had to -- we haven't wanted to even add them in Guarulhos, for example. So only 3 of the 24 new routes we've added year-over-year are in Guarulhos. In addition, we added capacity mostly by updating on another 77 routes. Of those, only 11 are former Avianca routes. So again, the vast vast majority of our growth has been in the Azul network.

If you consider all of the capacity addition that we have done over the last one year, it's over 100 routes that had been impacted. Only nine of them -- only nine of the 100 were in routes that have competition that was not former Avianca. So as John said, we've taken a short-term opportunity here in terms of some of the Avianca demand, but it's still a very, very small percentage of our focus. Avianca flew 59 routes, we're only in 20 of them. And out of the 226 routes that we have today, only 43 of them have any direct competition.

So we are well over 70% of our routes that we are alone. That trend is going to continue. These examples show that we have plenty of capacity growth, network growth opportunities in our own network given our hubs, our focus cities. We've really made an amazing network platform over the last 10 years. And so the vast majority of our growth has been in our own network. And last data point here, the A320s are flying today in 42 non-stop routes. Only three of them are new and in Guarulhos. That's it. All the others we've through those routes before and that's very consistent with our updating strategy.

So our story has not changed, our strategy has not changed. We continue to have this focus strength in our network. As we've said many times before, every time we had a larger aircraft in our own network, our network becomes even stronger even more defensible, a lot more connecting traffic goes through it and obviously much more efficient. So that's going to continue, has been our focus and will continue to be our focus.

A - David Gary Neeleman {BIO 687871 <GO>}

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Yeah, I think to Rogerio it's important to note that, yeah, we have some A320s in the Guarulhos airport because we have the most fuel-efficient aircraft in Latin America today and is the lowest unit cost and those tip costs in its range and so obviously in more competitive markets, you're going to put your best performing asset and so what we look forward to is when we can put all 320s in the Campinas a lot more places to deploy those assets.

Q - Rogerio Araujo {BIO 17308156 <GO>}

(inaudible) Thanks for the incredibly detailed answer, Bob. It's very useful.

A - David Gary Neeleman {BIO 687871 <GO>}

It helps to be prepared. Sorry about that.

Operator

The next question comes from Lucas Barbosa, Morgan Stanley.

Q - Lucas Barbosa {BIO 20835372 <GO>}

Good morning everyone and thanks for taking my question. I have two questions. The first one is kind of a follow-up to the first question Rogerio just did with regarding Azul's strategy in Guarulhos. If you could give us some color on how many slots of the anchor Brazil used to have in that airport and how much of them you were able to get. In addition, if you could just clarify these three routes in Guarulhos are the ones that you already added? Or if this includes the ones that you still plan to launch in the second half. That's my first question. Thanks.

A - David Gary Neeleman {BIO 687871 <GO>}

I thought Abhi was so detailed, we wouldn't have a follow-up to Araujo's question.

A - Abhi Manoj Shah {BIO 18968426 <GO>}

Well, I think for all of you, I have more details. But in terms of slots, so Guarulhos is obviously are not as-- it is constrained but it's not as constrained as Congonhas of course, so slots were available. Our Guarulhos is a ANAC slot controlled airport, so you can go and ask for slots and everybody has done that, not just us. If you look at the public data, we have added, goal has added and LATAM has added as well. And in many instances they have added more than we have in Guarulhos. So that's something to watch out for. But the new markets we've added are Guarulhos, Fortaleza, Juazeiro and El Salvador, so those are the only three new markets we have added that was former Avianca markets. And I think that we are still -- Guarulhos is still our fourth largest base in terms of departures.

And again, it's-- our focus is our network. One advantage we have is when we had some capacity in Guarulhos is we become a much more relevant and strong partner for our interline and codeshare partners so United, DAC, Copa. We all have cultures with European, Turkish. So they are all enjoying great capacity thanks to us right now and it's a

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very good incremental revenue for us. So again, it's our fourth largest base in terms of departures. We continue to focus in our network itself. We did take some opportunities as I explained. But it's been a small percentage of our year-over-year growth and I'm not expecting that trend to change.

And one final anecdote. If you look at the capacity data, you see how focused our capacity has been in our own network. Look in Brazilia, for example, we hardly have any growth in Brazilia. Look in Real for example. We hardly have any growth there. Look in other cities in Northeast. We are really focusing where we are strong and where we see the opportunities. So I think we are being very disciplined and being very true to our strategy.

Q - Lucas Barbosa {BIO 20835372 <GO>}

Perfect. Thanks for the additional details, Abhi. My second question is regarding the share of your network with no competition. So it's actually a follow-up from the slide 5 in your presentation. Do you have an estimate of how much of your routes and percentage of ASKs will have no competition in 2020?

A - Abhi Manoj Shah {BIO 18968426 <GO>}

Yeah, so in 2020 we expect the trends to be very similar to what we have today as we are adding A320s and our own network. Actually, the percentage of revenue is growing in our own network with the up gauging of these aircraft in our own network along with the ASKs. So I'm not expecting significant changes in these percentages or these graphs on what we have today.

Q - Lucas Barbosa {BIO 20835372 <GO>}

Perfect. Thanks very much for the color, Abhi.

Operator

Our next question comes from Daniel Mckenzie, Buckingham Research.

Q - Daniel Mckenzie {BIO 15071178 <GO>}

Hey, good afternoon guys. Congratulations on the results here. Couple of questions, Abhi, one of your competitors has chosen to go down the path of no hub in Northern -- in Northeastern Brazil. So going back to one of your earlier conference -- comments in the previous question. Can you talk about to what extent Azul's increased relevance in the Northeast is contributing the system RASM and is it potentially at the expense of those with less network relevance in the Northeast?

A - Abhi Manoj Shah {BIO 18968426 <GO>}

Thanks, Dan. We're obviously very happy with our Recife hubs, and we're really happy that we were able to invest in this hub much before anybody else even started about Northeast hub. We actually launched this hub in 2016. It has grown. I repeated today is approaching what Bello Horizonte was maybe a year or two ago. And Bello Horizonte is approaching what Campinas was a couple of years ago. We have almost 70 departures or

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70 departures in Recife. We connect all of the Northeast capitals. Of course we connect Orlando and Fort Lauderdale as well. And I think we do have a disproportionate share of that demand because we have, like David like to say, if you provide convenient service, they will fly more.

And one great example of this is a city called Mossoro that we started last year, has a great university there and now students are traveling more than ever and it's a route that's doing really, really well. So I don't know -- I don't have their numbers so I don't know how much we're hurting their-- them. But what I can tell you is that it's a hub that has done very well for us. We are adding capacity this year and it continues to perform very well on a unit revenue basis. It's a focus for us and I think we'll keep-- we have a lot of A320s flying there because of the distance. It's a perfect South to North A320 market. It makes us very efficient and it makes it really hard for anybody to gain a foothold. So, it's doing very well and we will continue to invest in it and probably, we have a disproportionate share of Northeast demand because of the strength of our beefing up. That's probably true.

A - David Gary Neeleman {BIO 687871 <GO>}

And then this is the first time in the history of Brazil that the Northeast is ever really been connected. It's connected regionally. It's connected to other capitals. In the past, if you were in another Northeast destination and wanted to go another capital in the Northeast, you'd have to go down to Sao Paulo or Brasilia and so we believe that people travel a lot more because of that. And so Brazil is much more connected today because of what we provided in the Northeast. So it even allowed us to strengthen the flight that TAP brings into Recife. We actually have flights to Fort Lauderdale in there and so it's a really, really strong up of ours.

Q - Daniel McKenzie {BIO 15071178 <GO>}

Yeah, understood. Well, thanks for that. Another question, just given the volatility of the macro backdrop, the economic outlook in Brazil has gotten quite a bit worse from where we were at the beginning of the year. I just wonder if you can address the kind of the potential for lumpier growth in 2020. So, I know, John, you talked about wanting to accelerate the E2s here and go ahead. Re-orientate my thought process here. But rightly or wrongly US investors are just conditioned to believe that lumpy growth is bad, just because of the stress that can put on the operation and obviously with Avianca Brasil equity, there has been some really unique opportunities this year that are pretty easy to digest.

Yeah. We are just looking ahead to 2020, fleet growth has flown to 6% and I'm just wondering how squishy is that 6%? Is it likely to be fleet growth closer to 10% or 15% if you can get the E2s that you want? I'm just wondering if you can help us think about kind of a lumpiness around the growth rate that we might see next year.

A - John Peter Rodgers {BIO 17734009 <GO>}

Yes, so first of all on the macro, we've kind of gone through a five year tough period in Brazil. Our GDP has been flat to negative almost every year over the last five years and

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look at the results that we've been able to provide. I'm very optimistic with the new government. I'm very optimistic about the reforms. I mean just last night, the lower house finally approved retirement reforms. That's big news for Brazil. That's going to be-- that's going to be a game changer. And so I'm optimistic that 2020 is going to have some real solid GDP growth here in Brazil. But, one thing that we think about, and we want to show that on the slide in the presentation is the E1 to E2, that should happen in the depression.

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We need to do that. The faster that we can flip that fleet, the better and so the challenge that we've had is not finding enough homes for our E1s, but we want those E2s as quickly as possible. David highlighted two days of training for our pilots. So it's plug in play. Those aircraft arrived from Sao Jose dos Campos, arrive at our headquarters, and we're flying them right away and the pilots are ready to go and they can fly the E2 and E1 on the same day. And so, and as you look at, you said is absolutely correct. It's only about 6% increase in the fleet, but each one of these aircraft has 18 to 30 incremental fees and so obviously it's going to deliver over 10% more revenue on every single flight, lower ownership costs, lower fuel burn. And so I think you earn the right to grow Dan when you're expanding margins and that's what we're doing.

If you're not expanding margins, you're not doing stuff that's better in your business, then you shouldn't be growing. But what we are doing is, this network in this fleet gets stronger every single day. And so as we look forward, close your eyes and wake up in 2021, 2022, we are certainly playing the long game. We are extremely excited about 2020 because we're -- our exit rate is 55% of our ASKs, our next-generation aircraft and then every month that just gets stronger and we wanted to show you that 500 daily flights are happening on E1s. Those are not very economical aircraft. And so as you move on to what that looks like when you have the E2, it's pretty remarkable what this airline could look like in a couple of years.

A - David Gary Neeleman {BIO 687871 <GO>}

You wanted two things. The economics are so astoundingly different between those two airplanes that there is -- there's even incentive for us to take some impairment and take those planes out quicker and the payback is really quick. It's amazingly quick. So those are the numbers we're running and, but we have small form but we can even accelerate it and the profitability is completely different. And as John said, the time's really got tough. We should get rid of the E1s and get the E2s out immediately because that really is an amazing kind of different airplane.

Q - Daniel McKenzie {BIO 15071178 <GO>}

Okay. I appreciate the comprehensive answer you guys. Thanks much.

A - John Peter Rodgeron {BIO 17734009 <GO>}

Thanks, Dan.

Operator

The next question comes from Marcos Barreto, Citi.

Q - Marcos Barreto {BIO 20572041 <GO>}

Hi everyone. Thank you for taking my questions. My question on (inaudible). Just a couple of questions from my side. First, what is your thinking behind the deployment of the E2s? Are there domestic growth that have become better or now required more service? And my second question is when we think about the convoyance slots, is it too naive to think that the map and (inaudible) airplanes could satisfy minimum approach velocity requirements with lower loads?

A - Abhi Manoj Shah {BIO 18968426 <GO>}

I'll start with the E2 and then I'll let John answer the Congonhas ATR question. So, regarding the E2s, our strategy is very simple. It replaced the E1s. So, John and David said, we have over 500 daily departures today that we want to replace. We will start in our hubs. So, we know we have many, many corporate routes flying out Campinas we fly to Brazilia, six times a day we fly to Porto Alegre nine times a day, we fly to (inaudible) 11 times a day. All of those will get replaced with E2s and each one of those will have 14% less cost per flight and I will have 18 to 30 more pleased to sell. So our focus is going to be replacing E1s routes. It's going to be a great airplane for the corporate customer, very efficient for us and we just have so many of those high frequency corporate markets in Campinas in Confins, in Recife, in Porto Alegre, in Goiania, Cuiaba, all those kinds of places. And that's going to be our focus really for the first couple of years is just replace all of those.

A - John Peter Rodgerson {BIO 17734009 <GO>}

I mean ATRs. We are the world's largest operator of ATR. Okay? And so is, I mean with our safety team I meet with our operations team. The aircraft should not be landing at that speed and so it is where it's factual if not maybe it's factual. And so, what I find to be disappointing is you have a highly congested airport that has restraints on it and you shouldn't be using the main runway to fly with ATR aircraft. There's an auxiliary runway that's provided for that. The best way to get fares down in Sao Paulo, is to have more operations on the main runway and so we're optimistic. We, this has been a long battle and as I said before, we're playing the long game and we believe the right thing will be done and the more operations we can get it that airport on the main runway is the best thing for Brazil, is the best thing for the consumer. And that's-- we stand behind that. Having main runway operations from small operators only increases growing TAMs presence in that airport, and that's not good for anybody.

Q - Marcos Barreto {BIO 20572041 <GO>}

Okay. Thank you, that's great color. Just one quick last question. Are you aware of any foreign interests in domestic slots?

A - Alex Malfitani

No, we are not aware. We haven't heard anything. No.

Q - Marcos Barreto {BIO 20572041 <GO>}

Okay, thank you very much (inaudible).

Operator

Our next question comes from Michael Linenberg, Deutsche Bank.

Q - Michael Linenberg {BIO 1504009 <GO>}

Oh hey. Just a quick follow-up. And Abhi, I think you answered my question and it really had to do with the economics of the E2 versus the E1, the 14% lower trip cost, 10% more revenue. I just was trying to get a sense of the seating configuration and how much it actually deferred now. Abhi you said 8 to 30 and I know you have multiple seating configurations on your E1s, but the difference 8 to 30 seems like a pretty wide range. What, do you have one airplane out of like 110.

A - Abhi Manoj Shah {BIO 18968426 <GO>}

Yeah, Mike, our E2s will have 136 seats. We have E903 with 106 and we have 195 with 118. So it's 18 to 32.

Q - Michael Linenberg {BIO 1504009 <GO>}

That's perfect. That's great. Thanks for that. Thanks for clarifying. Thank you.

A - Abhi Manoj Shah {BIO 18968426 <GO>}

David is yelling at me because he wanted 138, but that would mean the equipment would be in the overhead bin and my customers would hate it, so it's 136.

A - David Gary Neeleman {BIO 687871 <GO>}

You didn't realize the overhead bins are enormous. The bags in there in NY but whatever. I think what's -- what's the point of--and on the E2 as we do all the numbers and it looks like versus same seat mile costs as our 320s. So you can imagine a plane with the 3 mile cost as the 320neo but with only 136 seats. So it should cost and be absolutely much better than the 320 so there will be some routes, like Abhi mentioned like are really high density business markets where we can put an extra frequency, which gives out the conditional power and because we have that low trip cost from even the 320neo.

And one thing, it's really important is the ownership costs on our E2 is less than our E1s. Significant.

A - Abhi Manoj Shah {BIO 18968426 <GO>}

Yeah.

Q - Michael Linenberg {BIO 1504009 <GO>}

That's said. Thanks for that. Thanks everyone.

A - Abhi Manoj Shah {BIO 18968426 <GO>}

Thanks (inaudible).

Operator

The next question comes from (inaudible), Barclays.

Q - Unidentified Participant

Hi, thanks everyone for having me on. Just a quick question from me. As you have been focused on the domestic network and expansion there, has there--has it made you kind of revisit some of the importance of growing some of your international -- your international relationships to maybe kind of build that-- the feed through the domestic network, whether it's expansion of current relationships or even a potential of an alliance. How important is that going to be in the strategy to really kind of maintain and continue to build the domestic network?

A - Abhi Manoj Shah {BIO 18968426 <GO>}

Yeah, hey, Matthew. Yeah, it's really important. You're right. And you know, frankly, it wasn't something that we had a lot of focus on. The first 5 years, 6 years of Azul and now we do which is great. So, we recently announced an interline with Avianca. We have Codeshares with United, with GAAP, with Ethiopian, with Turkish with Copa and we certainly have a great pipeline of new partners. Really what international partners, one is network and frankly that's why some of our competitors have better partnerships than we do. We did not have the network, now we do and that's really attracting partnerships to Azul. So we have a pipeline that's very strong, that we'll be announcing periodically, frequently in fact.

And what's important-- an additional level as you move up the scale is joint ventures. So we've talked a lot about our joint venture with GAAP. We're working very aggressively to make that happen. We'll announce something very soon on that. We've talked in the past about our joint venture with United and our partner sort of Northern South America. That's something that's still very much in discussion. And we, we're engaging on that as well. So I think that as we grow out this network with these efficient aircraft, we will be more attractive to inbound partners and that's certainly something that we want to use to our benefit and we want to be a great partner to them as well.

And as we add frequency, as we add routes to these airports, you will certainly see that share for us growing. We haven't focused on it before, but now we have the network and we have airplane to do it. And so, interline code shares are going to be very important and in joint ventures is the next step after that. In terms of alliances, it's not a priority for us right now. I think we have some great partnerships already especially, United and GAAP and we're very happy with them. And so we're not really focused on alliances right now, but definitely interline culture and joint ventures.

Q - Unidentified Participant

Okay, great. That's all from me. Thanks, sir. Thank you.

Operator

Our next question comes from Savi Syth, Raymond James.

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Q - Savi Syth {BIO 17476219 <GO>}

Curious on the fleet side, what your appetite for the lay A320neo or the LR or the XLR.

A - Abhi Manoj Shah {BIO 18968426 <GO>}

Yeah, so on the A321, Savi, we are definitely interested right now at least in the domestic version. We have some slated to arrive. There are some delays on the A321 specifically. So we'll see how it goes. But we have a couple slated to arrive next year and we are very interested in that aircraft for our domestic route network. The LRs and the XLRs, we have looked at. The performance out of Brazil is not yet where we want it to be, but it certainly is a potential for us down the road. But right now, what I can say is the 321 domestic, it's certainly something that I'm very interested in.

A - David Gary Neeleman {BIO 687871 <GO>}

On the 321 LR that we came in kind of disappointing with a shorter range than Airbus had projected and much like kind of a -- and top carriers primarily use the LR to fly to the United States. Different-- I mean TAP's different and that's--we're thrilled with our investment in TAP because they can fly the LR and hit northeast to Brazil and northeast United States, so similarly, some of the most important routes with the LR or just beyond reach of what the LR can do so the XLR really means more or less and so that's things that are coming for 2023. So we are doing some work on the XLR and we would expect that to work for us, much better than the LR would. So that's like I said still few years away. I don't understand how it takes some three years to change a fuel tank. Whatever.

But LR doesn't make much sense. XLR makes more sense just like it does for Europe to the United States.

A - John Peter Rodgerson {BIO 17734009 <GO>}

If I can just give a quick update. David mentioned TAP and he mentioned it briefly, but the 321 LR is a real game changer for that. I mean they are flying into Boston today. They are flying it to Newark and a lot of what you're seeing in the fleet transformation that Azul is doing TAP is doing as well. They had the oldest fleet in Europe and now the youngest fleet in Europe and so very exciting things that are happening at that.

A - David Gary Neeleman {BIO 687871 <GO>}

Let's say, margin expand -- I'm saying what's happening here, we're seeing the margins go up at the same rate.

Q - Savi Syth {BIO 17476219 <GO>}

Thanks. That I can that ties right into is, I think you about nice follow-up. My second question on this is just what your objective for the top investment is and how that's going.

A - Abhi Manoj Shah {BIO 18968426 <GO>}

I'll just expand a little bit. I mean the thing that's still, that-- is that we have our management teams there. Antonioaldo Neves is CEO, Rafa who was here. You all know

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the CFO and they're going by the same game plan and I think it's just making it better and we see projections going out through year 20 and 21 and 22 with the same kind of like I said, margin expansion. That's kind of a closed airport. I mean there is no, it's very soft control. It's like you can go inside Europe in a sense that you could get in-- Ryanair can't really come in though. They have servicing but they can't grow so we're up gauging, bringing in new airplanes and so we're real excited about it. Now we have lots of options going forward, certainly have an IPO option, strategic partnership on our head, potentials-- as you have all kinds of things. And so the best thing to do is to build a great company and then we have even more options and that's what we're in the process of doing.

A - David Gary Neeleman {BIO 687871 <GO>}

Yeah. And I think we wouldn't have increased our participation last quarter had we not believed in all of the upside that exists there. So, we believe strongly what happened.

Q - Savanthi Syth {BIO 17476219 <GO>}

Thank you.

Operator

(Operator Instructions) This concludes today's question-and-answer session. I would like to invite John to proceed with his closing statements. Please go ahead, sir.

A - John Peter Rodgerson {BIO 17734009 <GO>}

Great. Well, thank you everybody for your support and we're working really hard to continue to deliver great results and as you said, we are playing the long game here. As we look at the balance of this year into 2020 and 2021, we're very, very excited. We look forward to hosting all of you Brazil at our facilities. You will get to see the great E2, you'll meet a lot of our great crewmembers at Azul, you get to meet our university and at our expanded management team. Thank you. Thank you all for your support and as always, we're available for questions if any of you want to do individual calls with management team. Thank you.

Operator

Ladies and gentlemen, that does conclude the Azul's audio conference for today. Thank you very much for your participation and have a good day.

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