

Q1 2019 Earnings Call

Company Participants

- Abhi Shah, Chief Revenue Officer & Member of Board of Executive Officers
- Alexandre Malfitani, CFO, IR Officer & Member of Board of Executive Officers
- Andrea Bottcher, IR Manager
- David Neeleman, Chairman
- John Rodgerson, CEO & Member of Board of Executive Officers

Other Participants

- Bruno Amorim, Analyst
- Daniel Mckenzie, Analyst
- Josh Milberg, Analyst
- Michael Linenberg, Analyst
- Renata Faber, Analyst
- Rogerio Araujo, Analyst
- Savi Syth, Analyst

Presentation

Operator

Hello, everyone, and welcome to Azul's First Quarter 2019 Results Conference Call. My name is Paula, and I will be your operator for today. This event is being recorded. (Operator Instructions) I would like to turn the presentation to Andrea Bottcher, Investor Relations Manager. Please proceed.

Andrea Bottcher {BIO 20316630 <GO>}

Thank you, Paula, and welcome all to Azul's First 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 detail in our earnings release.

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

David Neeleman {BIO 687871 <GO>}

Great. Thanks, Andrea. Welcome, everyone, and thanks for joining us for our first quarter 2019 earnings call. As always, I would like to start by thanking our crewmembers who work hard every day to provide our customers with their best travel experience in the industry. Over the past 4 years, we have created our ability to grow while maintaining our operational excellence and great customer service.

Of all the awards given out in our industry, I value the TripAdvisor awards most because it comes from the actual travelers, not some judges somewhere. Last month, once again we were selected by TripAdvisor as one of the top 10 airlines in the world and received a record 6 awards: Best Airline in Brazil, Best Airline in Latin America, Best Low-Cost Airline in Latin America, Best Economy Class Airline in Latin America and Best Business Class Airline in Latin America. It was a clean sweep. We won every single award. This is a true testament to the strong culture of the 12,000 crewmembers that show incredible dedication in taking care of our customers every single day and on every single flight.

In addition to having a strong culture and excellence of customer service, we have the strongest network in Brazil, and it's getting stronger. Today, we fly 113 cities. We are by far the largest airline in Brazil by number of flights and destinations served. During the quarter, we added 3 new destinations to our network and announced 2 additional destinations in the state of Sao Paulo. We are the largest airline in the state of Sao Paulo, and thanks to Governor Doria's travel incentive program, we will now benefit from the reduction in the fuel taxes from 25% down to 12% starting on June 1, which is really great news.

The Brazilian market has a lot more room to grow. Over the past decade, we have gone through several periods of macro volatility in Brazil, and the aviation market has doubled in size. Brazilians will travel significantly -- Brazilians still travel significantly less than other Latin American countries, which makes us confident that the market will continue growing over the next decade as we continue to add more convenient and economical travel options for our customers. This is why I couldn't be more excited about our fleet transformation plan.

As I have been telling John and the team, my goal is to accelerate the introduction of the A320neos and E2s as fast as we can. The weak real and the higher fuel prices make these planes even more valuable to us. This quarter alone, we added 5 neos to our fleet, replacing 4 E-Jets. And today, we have 26 flying in our network. The 320neos represent only 34% of our first quarter capacity.

So our fleet transformation plan is just beginning. Just a little over 25%. We got a lot to go. Our 320neos are flying more than 14 hours a day, one of the highest utilization rates in

the world. The E2s will start coming around September, and we should have 6 of them by the end of the year.

I've been in this industry a long time, and I'm truly surprised by the impact the 320neos have made in our network. We continue to add capacity, and we haven't seen a decrease in RASK, which is really so astonishing. And this fact has helped us offset weaker currency and higher fuel prices. So it's amazing to have that surge in revenue to help us get over these macro bumps. We added 34% ASKs since 2016, and our revenue has increased 50%. That really is truly amazing. Like I said earlier, our network is performing better than ever and better than I could have ever imagined.

In summary, Azul is not only getting bigger, but we're getting better every way. I couldn't be happier with the great job our management team and our crewmembers are doing. I'm so proud to be part of this great company.

And with that, let me pass it over to John to give you more details on the first quarter.

John Rodgers {BIO 17734009 <GO>}

Thanks, David. I also want to thank our crewmembers for all their hard work during the past quarter. We started the year with a more challenging macro backdrop compared to 2018. Nevertheless, we delivered a net income of BRL 138 million while running a great operation.

As you can see on Slide 4, operating revenue increased 16% to BRL 2.5 billion. We added 16% more capacity and saw a healthy domestic demand environment. RASK adjusted for stage length increased 1.8% year-over-year.

As we look at bookings for the next few months, we are very optimistic with our revenue outlook. Over the last 30 days, a lot has changed in the competitive landscape as 85% of Avianca Brasil's capacity has exited the market. As a result, we expect to see healthy increase in RASK year-over-year going forward for the rest of the year.

Our operating result was mostly impacted by the 16% depreciation of real and the end-of-the-payroll tax relief program and the 8% increase in fuel. CASK adjusted for these items dropped 2.4%. As we continue to add more fuel-efficient aircraft to our fleet, with the addition of more next-generation aircraft to our fleet, including the E2 starting in the third quarter, we should continue to see a significant drop in our unit cost.

Moving on to Slide 5. Fuel and currency had a negative impact of BRL 74 million on our first quarter operating results or approximately 3 margin points. We also had 2 margin point negative impact from the end-of-the-payroll tax relief program. Thanks to our margin expansion strategy, our ability to recapture revenue and reduce cost, we recorded an operating margin of 13.2%, recovering 3 of the 5 margin points during the quarter.

Moving on to Slide 6. Our loyalty program, TudoAzul, maintained its strong growth pace during the first quarter, reaching more than 11 million members. Gross billings ex Azul were up 31% year-over-year as we continue to focus and grow this business.

On the right side of the slide, you can see that our cargo business continues to perform extremely well. Revenue increased 41% year-over-year, benefiting from the expansion of our network and fleet. Among the passenger airlines in the country, we are already the second largest in terms of cargo revenue, and our volume share increased from 13% to 19% year-over-year.

We told you that our margin expansion story is a multi-year growth story. We wanted to highlight that TudoAzul and cargo revenue had doubled over the last 2 years, showing that our margin expansion strategy is working.

As we look at the balance sheet on Slide 7, I'm proud to report that we ended the quarter with a very strong liquidity position, representing 42% of our last 12 months revenue. Our receivable balance increase shows the strength of our cash position. We could have advanced hundreds of millions of receivables but chose not to given our cash balance. If we were to advance all of our receivables, our leverage would have been below 3. Our balance sheet is further protected against currency fluctuation through assets such as our security deposits, maintenance reserves and our TAP convertible bond, which are priced in strong currency.

With the new accounting standard IFRS 16, when new aircraft arrives, we immediately see an increase in debt on the balance sheet, reflecting the full term of the lease. But we don't yet see the earnings. The addition of 5 new A320neos to our fleet during the first quarter contributed to a disproportionate amount of debt and leverage without the benefit of the additional earnings. This will be compensated over time as these aircraft will become fully productive in terms of earnings generation.

Moving on to Slide 8. As you know and as we've talked about many times, we have a multi-year margin expansion plan based on 3 pillars: the transformation of our fleet with next-generation aircraft; our loyalty business, TudoAzul; and the expansion of our cargo and ancillary revenue business. As you can see on the bottom of the slide, we're just getting started. On the fleet transformation, only 34% of our ASKs were on next-generation aircraft in the first quarter. And cargo -- our cargo business and our ancillary revenue business is only about 50% of the way there. And TudoAzul also continues to perform well.

As we look forward to the remainder of the year, we continue to focus on running a great operation, executing our margin expansion plan and increasing our efficiency. We are confident about the future of the Brazilian aviation market and our ability to continue expanding margins, all while creating the best experience for our crewmembers and customers.

In summary, we're confident with the guidance we provided earlier this year. Given the situation with Avianca Brasil, we may make some adjustments for capacity, and we'll

update the market once we move more visibility on the outcome of Avianca's judicial recovery process.

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

Questions And Answers

Operator

(Operator Instructions) Our first question comes from Josh Milberg, Morgan Stanley.

Q - Josh Milberg {BIO 19336060 <GO>}

Good morning everyone. Thank you very much for the call. I just wanted to ask if you could talk a little bit about the big drop-off in your maintenance expenses in the period and the change of your accounting treatment there. We saw that on a combined basis, your maintenance and G&A cost grew by less than revenue this period. And therefore, without that effect, your EBIT margin might have come off a little further. That's my first question.

A - Alexandre Malfitani {BIO 2519089 <GO>}

Sure. Josh, it's Alex here. Yes. You got that exactly right. As you know, we implemented IFRS 16. We used to extend a lot of maintenance for our leased aircraft and now that maintenance will be capitalized. Also, remember from the previous quarters that we have started in-sourcing some of our maintenance activities, spare parts inventory given the economies of scale that we have today and also our lower cost of capital. So that plays into that as well.

And so you got that right. You got to look at -- from 2019 on, maintenance OpEx will go down and depreciation will go up. And I think the best way to think about it is that given the current FX levels, you can expect depreciation to be around the same level as Q1 going forward. Maintenance maybe was a little bit lower than average. Maybe something like BRL 70 million a quarter would be our expectation going forward. So that should help you figure out what it will be.

Q - Josh Milberg {BIO 19336060 <GO>}

Okay. That's great, Alex. But that change in accounting treatment was not about IFRS 16 because we saw that you had restated your first quarter numbers. Is that correct?

A - Alexandre Malfitani {BIO 2519089 <GO>}

Correct, yes, yes. So C check, we're in-sourcing as well. So there is a lot happening here but not IFRS. But IFRS is important because of the big difference from sort of the normal number for maintenance and depreciation that everyone has been used to seeing so far by the way.

Q - Josh Milberg {BIO 19336060 <GO>}

Okay. That's great. And then just while on the topic of maintenance expenses, you guys mentioned there's a reduction of the 4 E-Jets in your operating fleet this period. And I just wanted to ask if you could talk a little bit about your policy for provisioning for maintenance related to the retired aircraft and then if that's something you've done -- did in the last quarter or something you'll need to do in the coming quarters.

A - Alexandre Malfitani {BIO 2519089 <GO>}

No. So this quarter, you don't -- we did exit 4 aircraft from the fleet, but the maintenance is just an ongoing thing that's going to be happening. So nothing to highlight. If we highlight, as we've done in the past, remember at some point when we had a big number that really was nonrecurrent or was extraordinary, then we will highlight it. We will be replacing the EJs in our fleet. Some of that depends on market conditions and where we can find homes for these aircraft. And we will highlight that for you. But we do provision that along with the lease.

Q - Josh Milberg {BIO 19336060 <GO>}

Okay. But just sort of confirming, no big extraordinary values expected in the coming quarters related to those retirements?

A - Alexandre Malfitani {BIO 2519089 <GO>}

Correct.

Q - Josh Milberg {BIO 19336060 <GO>}

I'll tell you that's great that you're a much thank you.

Operator

The next question comes from Savi Syth, Raymond James.

Q - Savi Syth {BIO 17476219 <GO>}

Good morning everyone. Just on the domestic front, I was wondering if you can expand on kind of what you're seeing on the pricing side given fuel and FX kind of going against you but then also maybe capacity getting rationalized. So if you can kind of give us a little bit of color on what you saw in 1Q and what you're seeing so far in 2Q.

A - Abhi Shah {BIO 18968426 <GO>}

Savi, it's Abhi here. Yes. So 1Q, we actually had a very good January and February. Carnival was this year. We always prefer Carnival earlier. It gets the country started. So that affected us a little bit. And then probably the back half of March was maybe a little bit slower than we thought. But we've been off to a very strong start to second quarter. Bookings in April have been very good. Bookings in May so far, very high volumes.

Sort of a good balance between volume and fare. So the industry is pricing very rationally. The industry is taking advantage of the situation. It's behaving rational. I'm not seeing any

negative influences. So strong revenue, strong volumes. Probably the year-over-year increases in revenue, maybe half of it is volume, half of it is average fare. I'm also seeing a very good balance between the revenue coming from travel agencies and the revenue coming direct to our channels. So that's performing well also.

So overall, I'm actually very happy with the domestic industry and very optimistic actually. That's been our focus. You could see from the April traffic results how well our April traffic did. It was strong, 22% RPK growth, domestic ASKs of 17. So we're happy with that. You guys know we're not a low-fare -- we don't have the lowest fare. So the revenue is coming in good as well.

So summary, strong April, strong May, seeing good revenue trends -- strong revenue trends, equally balanced between fare and volumes and equally balanced between sort of corporate and on the direct channel side.

Q - Savi Syth {BIO 17476219 <GO>}

Okay. That's helpful. And then if I may just on the international side. What's happened especially with Argentina and the uncertainty? How much of a drag is that? And as you grow more domestic as the year goes by, do you kind of expect international to have lower contribution?

A - Abhi Shah {BIO 18968426 <GO>}

Yes. So specifically for Argentina, we have very low exposure to Argentina, only 2 nonstop flights a day. So it's a very, very small part of our business. International actually was a positive surprise in first quarter. If you remember, I said that I thought it would only become RASM positive second half of the year. It actually is going to start become RASM positive second quarter and onwards. So it's actually been better than I expected.

Good discipline again on the capacity side. U.S., Brazil, specifically capacity is going to be down mid-teens May onwards. So that's going to be positive for everybody.

I'm not expecting anything different from us on the international. Very disciplined, no major network changes. We just have Porto starting in June, but other than that, no new destinations. Just managing some frequencies here and there. But you will see very, very disciplined on the international side. And yes, as we grow domestic, it is going to become a smaller part of our overall business, which honestly given the current dollar scenario and the fuel scenario, as I said before, I think the opportunity for us with our fleet is on the domestic side.

Q - Savi Syth {BIO 17476219 <GO>}

Thank you.

Operator

Our next question comes from Michael Linenberg, Deutsche Bank.

Q - Michael Linenberg {BIO 1504009 <GO>}

Hey good morning everyone. A couple of questions here. And I realize the Avianca Brasil situation is somewhat fluid, but suppose there is no auction, how does it play out with respect to the assets? I'm just curious of your thoughts. And by the way, who is funding that company right now? Because it seems like that they probably burnt through all the cash that was going to be offered up by at least the 2 participants who are approved for this reorganization plan. Where is that cash coming from? Just any thoughts on those topics would be great.

A - John Rodgerson {BIO 17734009 <GO>}

Mike, it's a sad situation unfortunately. And our hearts go out to the crewmembers of Avianca Brasil, and there's 5,000 people that work for that that company and they have great customer service and have been great competitors over the last few years. Unfortunately, the money has run out. And as you said, it's a very fluid situation. From our read, payroll has not been paid yet this month, and they're about 5 days late. And so the airline is significantly smaller than it was, and there's been an injunction to stop the auction process because a lot of people questioned the way it was done.

And so I think overall, it's a sad situation, but it's positive for the industry overall. And Abhi is kind of talking about what's happening with the revenue trends, and we should benefit, getting some slots in almost any scenario that we look at. And so we're watching it very closely. The outcome is very uncertain at this point in time, but what we would like to kind of highlight is we have an operation that runs 800 flights a day, Mike, and we're going to continue growing over the next 2 years. And this is really a congenious play and congenious would have been an incredible cherry on top of the cake for us to kind of show our product in that market. And it's an important market in Latin America, but we don't want to overstate that our business model never depended on that airport.

And so if we have a chance to get some additional flights in there, we're going go for it. We're going to show what great customer service we have and show them what we've done elsewhere. But we're going to continue watch it. We're going to look at it. And we're hiring Avianca people every day because there's a lot of great people coming from that airline into the Azul family.

Q - Michael Linenberg {BIO 1504009 <GO>}

Great. And then, John, can you update us just on the fleet plan because -- can you tell us what that fleet plan was on the last call since subsequent to that, you have picked up some additional airplanes, and I think you've sort of earmarked some of the assets from Avianca Brasil? Like where was the fleet going to? And where is it going to now just based on maybe pending transactions or transactions that have been completed? Because you did mention that your capacity forecast, it was a little bit up in the air. We all understand that there's a lot of moving parts here. But if we can get a sense of maybe what the incremental fleet will -- the size will be, we can do that capacity calculation on our own. That would be great.

A - John Rodgerson {BIO 17734009 <GO>}

FINAL

Mike, that's a fluid situation as well. I think -- you saw our capacity growth. Obviously, we're watching very closely what happens with Avianca. We're interested in some of their assets, as you know, and we're interested in the next-gen assets that they have, the neos. And so you will see us add a few of those, but the timing is uncertain as to when they exit and are ready to kind of come back in.

And so I think you will see an update from us in the next 30 to 60 days on kind of what our new capacity plan will be based on kind of what happens with the auction process and what happens if something different happens. And sorry to kind of avoid the answer, Mike, but it's pretty fluid because we're working through that with each of us right now. We don't want to lose leverage with some negotiations as we move forward.

Q - Michael Linenberg {BIO 1504009 <GO>}

That's a fair answer. If I could just squeeze in one last one. This is probably more Abhi or maybe John. You look at your forward schedule and over the next, I don't know, 4, 5 months, it does look like that some of your frequency between U.S. and Brazil are getting cut. They seem to be -- it looks like they're getting scaled back. Is that a demand issue? Or is that a delivery delay with the A330-900 neos that you're not getting them fast enough and you have to go back and cut the schedule a little bit? Demand or manually on issues?

A - Abhi Shah {BIO 18968426 <GO>}

Mike, yes. So the A330 neos have seen delays. We're probably going to be pushing out the second airplane towards the second half of the year, late second half. So that's affected some frequencies as well specifically to the U.S. And again, I want to make sure we're disciplined. And so for example, some days of week where we don't need the second daytime Fort Lauderdale, we won't fly second daytime Fort Lauderdale. But we have had A330 neo delays. The second one that was supposed to be sort of June, July time frame is probably late second half of the year now.

Q - Michael Linenberg {BIO 1504009 <GO>}

Thank you. That's right.

Operator

The next question comes from Bruno Amorim, Goldman Sachs.

Q - Bruno Amorim {BIO 17243832 <GO>}

Hi good afternoon. So I have a question on the guidance for the full year. You have delivered an EBIT margin of 13% now in the first quarter versus the guidance of 18% to 20% for the full year. So what should drive much higher margins in upcoming quarters in your view? Is it the Avianca Brasil situation? Is it something else? Any color in that sense would be helpful.

A - John Rodgers {BIO 17734009 <GO>}

Bloomberg Transcript

FINAL

Thank you. There's a lot of factors. I mean I think how we performed in the first quarter is exactly how we thought we would perform in the first quarter. So we're always stronger in the third and fourth quarters. We're positively surprised at the performance we're seeing in the second quarter. We've got a lot more aircraft coming in that are the A320neos and you've seen the growth in our ancillary business with cargo and TudoAzul. And revenue trends are coming. We also have the E2s that are coming on in the third and the fourth quarter, which add additional capacity with lower fuel cost.

And so there is a lot of factors. And as we look at our margin expansion pillars that we showed you, first quarter is the toughest quarter for the year-over-year comp. Last first quarter, I think exchange rate was 3.15 and this year it was around 3.90. And so you don't have that tough comp in the second quarter, third quarter and then the fourth quarter. And so that is performing extremely well in the revenue trends, and we're growing the business and executing exactly how we thought.

Obviously, currency and fuel prices are a little bit of headwinds. But I think when a competitor takes 85% of their capacity out of the market, it makes up for a lot. So I think there's a lot of factors that go into it. And we're very early in the year, and we're feeling very good about our ability to execute and to continue delivering.

A - Abhi Shah {BIO 18968426 <GO>}

Bruno, it's Abhi here. Just to add to that, our year-over-year RASK in the first quarter was flat. And we're expecting something like high single digit year-over-year in the second quarter. So that's going to be a nice boost on the revenue side. Coupled with the capacity increase, that's going to help the unit cost. So that's really what's going to help also going forward.

Q - Bruno Amorim {BIO 17243832 <GO>}

OK. Thank you. And could you please just confirm if your RASK was also positively impacted by the end-of-the-payroll tax benefit? I understand you had your pay effects on revenue. Has it impacted in that RASK as well or not?

A - Abhi Shah {BIO 18968426 <GO>}

Yes. You could see that in our waterfall. We highlighted that, the exact amount that we benefited in the waterfall.

Q - Bruno Amorim {BIO 17243832 <GO>}

OK perfect. Thank you.

Operator

The next question comes from Rogerio Araujo, UBS.

Q - Rogerio Araujo {BIO 17308156 <GO>}

FINAL

Hi good afternoon thanks very much for the opportunity. My first question is a follow-up on Bruno Amorim's question on guidance. Actually, when you do an adjustment for maintenance expenses, so maintenance expense has been boosting margin by 3 percentage points, and this was first Q. If you look at last quarter, it was almost 5 percentage points, and historical level as well. So when we adjust the guidance for this capitalization of maintenance expenses, actually the top range of the guidance, which is 20 percentage points EBITDA margin, it becomes something between 15 and 17. So I'm talking about ex maintenance expenses capitalization. In accounting, we would say something between 9% and 11%. So my question is, is the guidance conservative, especially considering the EBITDA margin that is accelerating and also the surprise on deals as of the second Q. So that's my first question.

A - Alexandre Malfitani {BIO 2519089 <GO>}

Let me tell you a little bit how we kind of treat guidance and how we think about it when we provide it. Usually, when we give guidance, we know obviously there are some implied assumptions together with the guidance, right, on demand levels, economic activity, fuel, FX, things like that. And that's why we have a range, right? For a reasonable change in these assumptions, you can see us getting closer to the bottom end of the range or the higher end of the range. Usually, when we publish guidance, we are shooting for something in the middle of the range.

If things change and we are still landing within that guidance, we maintain guidance, right? And as John mentioned, we've had headwinds on fuel and FX. Certainly, they've moved against us since we published the guidance. So that would push us more towards low end of the guidance. But the upside from the revenue environment that has been much better than we expected, so that's going to push it towards the other end. So that's kind of how we feel about it. So feel that our total EBIT margin for the year still -- our expected value for that margin still lands within the range that we provided.

Q - Rogerio Araujo {BIO 17308156 <GO>}

Okay. Thanks so much. And my second question is also a follow-up on Avianca Brasil situation. So there's local news stating that the auction may not occur as it was planned in the last meeting. So my question is any possibility that Azul comes back with an agreement similar to that partnership or Azul completely discards now any kind of purchase of the assets of Avianca Brasil?

A - John Rodgerson {BIO 17734009 <GO>}

It's Brazil, man, everything is on the table. You'll never know. We're just watching the situation closely. It's actually been pretty entertaining to kind of see the ups and downs. And so I think what we have stated was the way the company was divided before didn't -- we didn't have much interest in it because if we went for Avianca Brasil, we needed a schedule that allowed us to compete in the average Rio and Sao Paulo. And I think we stand behind that, and I think that's the best outcome for the country and for us. But again, we have got no comments on where we are at right now, but we will watch it closely, and we'll look for opportunities as they present themselves.

A - David Neeleman {BIO 687871 <GO>}

I think the thing that was -- it was, I think, most tragic, I think, for the people that work there, that the way the plan came down and the 2 people that got the slots were basically the ones that have 95% of the airport today. So it's our belief and really given CADE statements that, that plan never had a chance to get approved anyway. So it almost looked like it was kind of a shutdown plan to us. It's just a way for them to shut down the company so that they would get their pro rata number of slots, which was really kind of sad for the people who are there now even working without salaries today. And sometimes things work out the way it should have worked out. So we'll see how it goes.

Q - Rogerio Araujo {BIO 17308156 <GO>}

Thanks very much.

Operator

Our next question comes from Daniel Mckenzie, Buckingham Research.

Q - Daniel Mckenzie {BIO 15071178 <GO>}

Yeah. Hey thanks guys. My question was actually on Avianca auction as well. I believe there was a suggestion by regulatory authorities that it was potentially an illegal auction. And I'm just curious. It's unclear if an auction even goes forward, but if it did, is there -- I mean with the assets that the airlines bid on, could they be at risk of being taken away by ANAC or CADE if it is viewed illegal? I'm just wondering if you could just help us understand further kind of the time line or how things would work out. I don't know if there's a decision that would be expected on that or if there's one -- I guess I'm just trying to get a sense of when or how you might know this might move forward or not.

A - John Rodgerson {BIO 17734009 <GO>}

Dan, we don't know. And I think there is -- as I said, anything is possible. As David highlighted, we believe that our competitors have a shutdown plan. And I think that's kind of where things are playing out. And I think that people are kind of seeing through that now. It took a little bit of time to see through that. But we will see. I think other creditors realized, wait a second, this is not what we had originally thought. And so we'll just have to let things play out. I think the authorities are looking at this very closely because when you have 5,000 people without salaries and a situation that's very complicated, we'll let the judges and lawyers and antitrust kind of work through that stuff. But we're going to continue running Azul. We're going to continue running our business, and we'll look for opportunities to expand in that airport as they present themselves.

Q - Daniel Mckenzie {BIO 15071178 <GO>}

Okay. Yes. Understood. And then just following up on an earlier question just regarding the aircraft deliveries. I believe you guys have got 10 aircraft deliveries coming from Avianca right now. Can you just talk about the flexibility to early retire more EIs without penalty? How many more -- is that something you'd even want to do? I'm just wondering if you can just help kind of flush out the fleet plan a little bit further and how you might deploy the planes.

A - John Rodgerson {BIO 17734009 <GO>}

Yes. So Dan, those aircraft aren't yet here or not yet closed. And so we're working through that. As I said, we want the next-generation aircraft that Avianca Brasil had. You need to be able to crew them. And so we're working through that currently as part of our growth plan. We always have the ability to retire the E-Jets early, and any time we do that, margin expansion comes even quicker. And so we'll continue to do that. 85% of the capacity of Avianca Brasil came out. They had about 13% to 15% of the total market share in Brazil.

And so there is a little bit of a vacuum that exists. And we believe that in all scenarios, only about half of that capacity will either be put back into the market, which I think is very healthy overall to Brazil, and it will be done with much more rational pricing. As you take a look at where our competitors are pricing, where we price, it's much more rational capacity. So it's overall very positive, and so we will be opportunistic as we move forward. But we need the aircraft to be delivered to us and as fast in order for us to take advantage of the opportunities that exist.

A - Abhi Shah {BIO 18968426 <GO>}

In terms of kind of we're going to use these airplanes, it's actually how we're going to use any airplane, right? I mean just to give you an idea, our A320 today, we have 26 of them, but they're only flying daily or more in 21 markets. And we have 169 jet markets. So that's a long way to go. If I look at all of my hub to hub or hub to focus city routes, 14% of those flights are still being flown by Embraers. So we have a long way to go just in our own network in terms of updating.

So in terms of how would we use A320s, it's in our own network to make our network even stronger. As David said, every airplane is just driving more traffic. So that's been our focus all along. Of all the A320 markets we've added, there's only one new market. And that's a continuous market. So our network is really broad. It's a huge platform of growth. And that's where we're going to be focused on for a while.

Q - Daniel McKenzie {BIO 15071178 <GO>}

That's perfect. I'm wondering if I can just squeeze one last one here. Now if we could just assume you guys get some slots from Avianca, growth is going to go up. Just wondering if you can help us connect the dots on increased cost versus the ability to effectively market the new service now with the starting blocks. Is this potential incremental growth likely margin-dilutive at first, so near-term negative before becoming additive longer term? Or is this growth -- how do you think you can kind of hit the ground running on?

A - Abhi Shah {BIO 18968426 <GO>}

Yes. No, I think that we can hit the ground running. Our network and the traffic it generates does a lot of sales and marketing for us. It does a lot of distribution for us. And so you should not expect any bump in marketing cost or distribution cost, special just to tell this. I'm very confident that given the broad base of demand that we already have and our reach in the domestic market this will be plug and play and actually expect it to be very

efficient capacity in terms of overhead and things that we already have. So it should come in very, very efficiently.

A - David Neeleman {BIO 687871 <GO>}

Dan, our TripAdvisor awards and our customers are out there screaming for us to enter more markets. It would be a great word of mouth marketing for us.

Q - Daniel McKenzie {BIO 15071178 <GO>}

Understood. Thanks so much for your time.

A - David Neeleman {BIO 687871 <GO>}

Yes thank you.

Operator

The next question is from Renata Faber, Itau BBA.

Q - Renata Faber {BIO 6774036 <GO>}

Thank you for the question. Congratulations on the results. Could you just talk a little bit about the cargo segment? Revenues increased substantially in the first quarter, and I also understand that you started flying the dedicated cargo aircraft in Q4 last year. So can you just talk a little bit about the growth perspective in this segment and also the profitability now that you are flying the dedicated aircraft?

A - John Rodgers {BIO 17734009 <GO>}

Yes. Thanks, Renata. It's actually -- cargo is doing really, really well. And one thing that we were doing is we're flying our 330s domestically just for some of our cargo contracts. And so what we decided to do is with those new cargo aircraft, we can actually deploy our 330s on the appropriate routes. And so what we've seen is a significant increase in our e-commerce business.

And we had talked a lot about the Correios joint venture. But when we sat down to negotiate with the Correios, we thought we were going to grow the business about 20% to 25% a year. And now we're growing 50-plus percent last year, 41% this year, and that's one of the reasons why we stepped away from it because we know that going it alone we can do much better.

And so this is a very important part of our business. You'll see us continue to dedicate resources to it. Our cargo team wants additional aircraft because they have demand. The problem is it's very difficult for us to crew it, right, because we're growing the overall business substantially.

But when we think about the logistics problem that exists in Brazil today and the fact that we're in 106 cities, we have over 240 stores, if you live in Sao Paulo or in the southeast of

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Brazil, logistics isn't a problem for you. You can buy stuff on MercadoLibre and it gets delivered to your house. But if you live anywhere else in Brazil, I think that we are the only airline that truly covers all of Brazil. And our cargo network really is desirable to all the e-commerce players.

And so it will continue to build that out over the coming years, and so we do not see this slowing down. It's going to slow down on a percentage basis just because the base keeps getting bigger, but we do not see our cargo business slowing down at all.

A - David Neeleman {BIO 687871 <GO>}

I mean we serve the 106 cities, but we have 3,200 municipalities we serve. So that's a much bigger number.

Q - Renata Faber {BIO 6774036 <GO>}

Okay. Thank you.

Operator

Our next question comes from Savi Syth, Raymond James.

Q - Savi Syth {BIO 17476219 <GO>}

I just had a follow-up question on the cost side. You said kind of 1Q came in as expected. Can you give us an understanding of what's the basis for the kind of guidance you provided for 2019? And just how much of that is going to be kind of back-end loaded? And maybe -- I'm guessing maybe you're thinking kind of the weaker end of that given how the FX has moved, but just any color on some of the guidance and how we should think about it on a quarterly basis.

A - Alexandre Malfitani {BIO 2519089 <GO>}

Savi, yes. So in terms of sort of those assumptions that we use, normally for fuel, we use the forward curve. And for FX, we use the Focus survey. Now the Focus survey seems to be a little optimistic these days. I think it's at 3.75. Hopefully, they're right. But we decided to be a little bit conservative. And so fuel and FX are kind of hovering around where they are today. And so that's how we forecast.

But like as we mentioned, I think the big changes that you will see towards the end of the year as we go from this point on until the end of 2019, there's a lot of the capacity that's coming in from next-gen aircraft. It's the new demand environment that we're seeing. And it's just the natural seasonality that we have that second half is always much stronger than first half for us.

So I think going back to what Bruno asked prior, that obviously we implied EBIT margin that we have to meet our guidance is higher than what we delivered in Q1, but that's all as we expected. When we published the guidance we saw that as well, and so we're kind of just

moving along with some tailwinds and some headwinds but still moving towards delivering that guidance.

Operator

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

A - John Rodgerson {BIO 17734009 <GO>}

I thank everybody for joining us today. We're very excited about the future and look forward to talking to you individually or at conferences. Feel free to reach out to Andrea and the team if you have any further questions. We have a lot of work to do and we're going to continue delivering. Thanks.

Operator

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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