

Q3 2019 Earnings Call

Company Participants

- Abhi Manoj Shah, Chief Revenue Officer
- Alexandre Wagner Malfitani, Chief Financial Officer and Investor Relations Officer
- Andrea Bottcher, Investor Relations Manager
- David Gary Neeleman, Chairman
- John Peter Rodgerson, Chief Executive Officer

Other Participants

- Daniel McKenzie, Analyst
- Josh Milberg, Analyst
- Lucas Barbosa, Analyst
- Michael Linenberg, Analyst
- Pablo Monsivais, Analyst
- Savanthi Syth, Analyst
- Stephen Trent, Analyst
- Unidentified Participant

Presentation

Operator

Hello, everyone, and welcome to Azul's Third Quarter 2019 Results Conference Call. My name is Beatrice, and I will 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 presentation over to Andrea Bottcher, Investor Relations Manager. Please proceed.

Andrea Bottcher {BIO 20316630 <GO>}

Thank you, Beatrice, and welcome all to Azul's third 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 would 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.

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

David Gary Neeleman {BIO 687871 <GO>}

Thanks, Andrea, and welcome, everyone, and thanks for joining us on our third quarter 2019 earnings call. As always, I'd like to start by congratulating our crewmembers and thanking them for another great quarter. We certainly couldn't do it without them. Thanks to their efforts we continue to deliver on our IPO promise of expanding margins. What we didn't highlight enough at the time of the IPO is that in addition to expanding margins, we have also increased revenue by more than 70% since the time of the IPO.

This year alone revenue should increase by more than 25% compared to last year. So the combination of expanding margins and growing revenue, again, a growing revenue base has led to an EBITDA to more than double since our IPO in 2016. That's incredible, and like I said, we always thought we would expand margins. I guess, we forgot to say about the part we are going to grow. So the bottom line is really growing. More importantly, we have demonstrated our ability to grow while maintaining our operational excellence and great customer service. This quarter, for the third year in a row, readers of Melhores Destinos, one of Brazil's largest travel site, selected Azul as the best airline in the country and TudoAzul as the best loyalty program, a true testament to our commitment to customer satisfaction. We're also proud to be ranked number one in all categories by Reclame AQUI, a customer satisfaction website, including best airline, best loyalty program, and best travel package program. What I am most excited about this quarter was the delivery of our very first E2, we've been talking about that for a while. The first one is finally here.

We have another 50 plus on order to be delivered over the next few years. The E2s have, as we've been telling you, have a lower trip cost that is 14% lower than the E1s, so we're actually getting better fuel performance than we've been anticipating. And it comes with 18 additional seats, so lower trip cost, 18 additional seats. That's nirvana for the airline business. It also gives us flexibility to connect dots that have never been connected before in Brazil. These are long, thin routes that -- like I said, have never been flown before, just tons of flexibility. We can also add additional frequencies in our business markets, very exciting airplane.

By the end of 2020, we should have 76 next-generation aircraft in our fleet, including A320neos and the E2 representing 61% of our ASKs. As we have been telling the market, with the addition of the E2s and the A320neos. We will continue to reduce unit costs while producing more revenue per aircraft.

As you can see on Slide 4, we still have a long way to go in our margin expansion story. The best news is that we are less than halfway completed. As I just mentioned, we have just started switching E1s with E2s in October and we have roughly 500 flights a day to replace.

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We're also thrilled with the growth of our business units Azul Cargo, TudoAzul, both which grew more than 40% in the quarter.

On Slide 5 you will see our latest network. We now have -- we now fly to 114 destinations, incredible, and have more than 900 daily flights. I've asked Abhi when we're going to hit that 1,000 flight and he guarantees me it's coming up in the not too distant future.

In Q3, we also started flying the air bridge between Sao Paulo and Rio, with 14 daily frequencies. This is the fourth largest market in the world and the largest in the Americas in terms of passengers. We are very pleased with the results we are seeing on this route.

In summary, we continue to deliver on our promise of expanding margins, while growing our top line by double digits. Our network is as strong as it has ever been, and I couldn't be more excited about the opportunities that lie ahead of us as we continue to benefit from our fleet transformation. I'm certain that it will create great value for our shareholders, crewmembers and customers.

And with that, I'll turn the time over to John to give you more details on the quarter.

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 continue to deliver great results.

As you can see on Slide 6, we grew our top line revenue by 25% to over R\$3.0 billion in the quarter and also expanding EBIT margin to 18.5%.

EBITDA reached a record R\$936 million, up 24% year-over-year. RASK on a stage-length adjusted basis increased 1.7% while CASK decreased 1.5%. Excluding the impact of the end of the payroll tax relief program, CASK would have fallen 4%. We had net income of R\$441 million, up 57% year-over-year if you remove the non-cash impact of currency variation.

Moving on to Slide 7, our cargo business maintained its strong growth with revenue increasing 42% year-over-year, benefiting from the expansion of our network and fleet. In August, we signed a commercial agreement with Mercado Libre, Latin Americas largest e-commerce player becoming their exclusive direct provider of air shipment for e-commerce in Brazil. Through this partnership, Mercado Libre will have the fastest shipping times of any e-commerce player, reaching more than 3,700 municipalities nationwide with the support of our extensive network.

E-commerce represented almost 20% of Azul cargo revenue in 3Q 2019, up from 9% in the same period last year. In addition to the growth in e-commerce, we're also growing our corporate customer base reaching a domestic cargo market share of 22%, the second highest in Brazil.

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TudoAzul also had a great performance during the quarter with gross billings ex-Azul increasing 40% year-over-year. This is TudoAzul's fourth consecutive year with over 30% growth. And as David highlighted, it is once again elected the best loyalty program in Brazil. Congratulations to the entire TudoAzul team for their great work.

Moving on to Slide 8, I'm proud to report that we ended the quarter with a strong liquidity position, representing 41% of our last 12 months revenue and this is while growing revenue by 25% year-over-year. Our balance sheet is further protected against currency fluctuations through our assets, such as our security deposits and maintenance reserves, totaling R\$1.6 billion. These are not included in our cash balance.

On the right side of the slide, we show an evolution of our leverage, which reached 3.3 in July with the new accounting standard when a new aircraft arrives we immediately see an increase in debt reflecting the full term of the lease without the benefit of the EBITDA these aircraft will produce. Adjusting for these five aircraft that we added during the quarter, our leverage would have been 3. We expect this timing effect to level off as these aircraft become fully productive.

On Slide 9, you can see that in addition to the improvement of our operating results and solid balance sheet, our operating cash flow was almost R\$1 billion. And we generated free cash flow of R\$187 million in the quarter.

Moving on to Slide 9, we wanted to highlight the significant investments we're making in our future, adding new aircraft, hiring pilots, in-flight attendants, we added 14 aircraft year-to-date including five planes in the third quarter. In Q4 we expect to add 12 next-generation aircraft. We also elected to convert some of our prior A320 orders to A321, allowing us to further up gauge our fleet in a margin-accretive way. Next week we'll receive our first A321neo and we plan to receive a total of 12 by 2022.

As you know, we've been actively marketing the EIs to accelerate our transition into an all next-generation fleet. We sold one EI in the third quarter and also sold one in the fourth quarter. We're happy to share with you that we've recently signed an MOU with an airline for the sublease of up to 32 EIs over the next few years. The EI95 served their purpose at Azul but once new technology came out, it's important we transition as quickly as possible. Consistent with our aircraft sales, the subleased will most likely result in a non-cash one-time book loss in the fourth quarter. We will finalize the exact amounts over the coming weeks and we'll update you as soon as the number is final.

Also consistent with the aircraft sales, given the great economics of the next-generation aircraft, this transaction is cash positive and margin accretive. We also invested in the construction of a new hangar, one of the largest and most modern in Latin America. The facility accommodates up to eight A320neos or two A330s and will help reduce our maintenance costs as we will be in-sourcing all of our narrowbody C checks.

We're also excited with our investment in TAP as it continues to make progress on its own fleet transformation plan. The recent consolidation events in Europe further reinforce the

value of our investment given TAP's strategic location and leadership position in traffic between Brazil and Europe.

In addition today, we've submitted for shareholders approval a proposal for our commercial joint venture with TAP, which we believe will be revenue accretive for both carriers in the coming years.

Wrapping up on Slide 12, we present our updated 2019 outlook. We expect our capacity to grow approximately 20% in 2019 and we remain confident on an expected operating margin for the year of around 18%.

In summary, we are building the best airline for our crewmembers, customers, and shareholders. This is a multi-year margin expansion story. I'm excited with what the company will look like one year from now, three years from now, and even five years from now, as we continue to build and invest in the best airline in the world.

David Gary Neeleman {BIO 687871 <GO>}

Just keep in mind, we still have 500 daily flights being flown by EIs.

Finally, I would like to thank our shareholders for their continued support. We will work to keep your confidence and expect to continue making progress on growing our business profitably.

With that, David, myself and Abhi and Alex are here to answer any of your questions. And we turn it over to the operator.

Questions And Answers

Operator

Ladies and gentlemen, thank you. We will now begin the question-and-answer session. (Operator Instructions). Our first question comes from Sav Syth, Raymond James.

Q - Savanthi Syth {BIO 17476219 <GO>}

Hey, good afternoon, everyone. The capacity for 2019 coming at the kind of towards the lower end, I was kind of curious if that's a function of aircraft timing or if you're kind of just reacting to the environment and with the -- it seems to kind of imply maybe a bit of a moderation in the fourth quarter. So should 4Q kind of RASM be at a similar level to what you're seeing in 3Q? Thanks.

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

Okay, Savi, I'll answer the first part and then pass it over to Abhi. Airbus, as well as Embraer has experienced some delivery delays from what they originally gave to us. And so that's primarily the difference in capacity as we look in the fourth quarter. Airbus has

not yet caught up and even Embraer has been delayed a bit on some deliveries, so that's really what the difference is from what we had previously forecasted.

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

Hey Savi, Abhi here. Yeah. Yes. So it was -- we had the deliveries that John talked about. We also have a couple of Embraers starting to exit the fleet for the exit process and that's happening in 4Q. And so, it's mostly fleet related, some exits, two aircraft exiting the fleet to begin the exit process and the new airplanes coming in with the date sliding around.

There also is a minor impact with the timing of the November holiday, the holiday is on a Wednesday. And so, we've kind of made adjustments around that, but it's mostly fleet stuff in terms of the -- why the ASK guidance has come down to the lower end.

In terms of unit revenues for 4Q, yeah, I mean, I expect them to be close to zero again. Keep in mind we have two very, very strong effects when it comes to year-over-year RASK. The first one is, you have a very high base from last year. Last year every month August, September, October, November were all record months for Azul in terms of our RASK. And so, we have a very high base that we're trying to get even higher this year. And we have the impact of the aircraft mix that we talked about at Azul Day. Just the fact that our A320s now represent so much more of our network than they did last year, they have up about 100% in capacity year-over-year. They're, obviously, they fly double the stage length and they're 50% bigger. And this effect is not really included in the stage length adjustment. So the fact that they're -- fly much longer, they're much bigger, they, on absolute terms, they have a lower RASK, and the effect of the -- the mathematical effect of the aircraft mix is a 7 to 8 point system-wide RASK impact.

And so, I think in 4Q will be, again, RASKs very close to zero as well, but in actuality were actually up 7 to 8 points because we're making up for the effect of the aircraft mix. So, hopefully, that answered the question.

Q - Savanthi Syth {BIO 17476219 <GO>}

Yeah. That makes sense. Helpful. So, just given the, the new EI announcement, any color on how we should think about growth next year, is that still pretty consistent or should we think about kind of slower or faster growth next year?

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

Yeah, I think you can expect growth for next year very consistent to what you have this year. It's going to bias more to with the E2s. Obviously, this year was more towards the EIs. And because the EIs are primarily in our network, in our hubs, in our corporate markets, the swapping out of the EI to E2s is going to be focused in our network, in our largest corporate markets where we have 9 flights, 10 flights, 11 flights a day, out of Campinas, out of Belo Horizonte, out of Hasifi. So the focus next year is going to be E2s. The ASK number is going to be similar to what you have -- what we have this year and it's going to be just focused on swapping EIs for E2s.

Q - Savanthi Syth {BIO 17476219 <GO>}

All right. Thank you.

Operator

Our next question comes from Mike Linenberg, Deutsche Bank.

Q - Michael Linenberg {BIO 1504009 <GO>}

Oh, hey, just a few housekeeping questions and then a bigger picture question. The A321neos, how many seats are they going to have?

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

Hey, Mike. Abhi here. A321s have 214.

Q - Michael Linenberg {BIO 1504009 <GO>}

Okay, 214. Okay, great. And that's also going to include your sort of exit extra room upfront type products that you have on the --

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

Yeah.

Q - Michael Linenberg {BIO 1504009 <GO>}

Okay, great.

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

Yeah, it's a domestic A321 with extra legroom upfront.

Q - Michael Linenberg {BIO 1504009 <GO>}

Okay, great. And then just a quick second here. I saw that you were reporting earnings per ADR, and I know in the past, I think it was per ADS, was there -- did you have any sort of like a legal change on the share structure? I realize this is kind of minor.

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

No, we use those interchangeably ADRs and ADS. There's no difference.

Q - Michael Linenberg {BIO 1504009 <GO>}

Okay, great. And then, Alex, actually since you answer that. A quick question just on the accounting, the difference between your reported loss. And then you had kind of net income as adjusted, you added back the foreign currency exchange hit. Are there any tax implications though as a result of adding that back? Is that just the straight add back or should we assume, apply some sort of tax rate to getting to like a true after-tax number, maybe it's not even applicable and you won't even apply taxes to that?

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A - Alexandre Wagner Malfitani {BIO 2519089 <GO>}

Yeah, no, it's a pretty straight add-back of sort of the impact of FX to our dollar-denominated debt, which isn't real debt, as you know that these days markets mainly the capitalized leases, right, so unfortunately, with IFRS 16, the volatility to earnings with FX are going to increase, because all of those lease cash flows get capitalized on a balance sheet and they get translated to R\$ every quarter based --

Q - Michael Linenberg {BIO 1504009 <GO>}

Yeah,

A - Alexandre Wagner Malfitani {BIO 2519089 <GO>}

On the quarter-end FX. So it's a -- but they don't -- when you calculate taxable income, that FX volatility does not apply, right. So, protectable income, the revenue service already kind of disregards the FX volatility. And so, you don't need to worry about tax impact when you add it back to net income.

Q - Michael Linenberg {BIO 1504009 <GO>}

Okay, great. That's helpful. And then just lastly, maybe this is more of a question to David, you referenced recent consolidation in Europe and we now have another marker out there for a carrier which, in this case, it is a carrier that had a decent presence between Latin America and Europe, and yet when I look at the numbers, I believe TAP is actually a larger carrier, maybe 1 point or 2 point of share larger than Air Europa, just thoughts about that transaction and kind of how it sort of how you think about it vis-a-vis TAP?

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

Absolutely. I think Air Europa is maybe a little bit stronger in the rest of Latin America and TAP is really strong in Brazil. I think if you were to take what we have scheduled for next year in -- between the JV between TAP and Azul, I think, there's like 100 weekly departures going to Europe from Brazil which is far and away the largest carrier.

I think we have about 30% of all of the passengers that fly between Brazil and Europe, which is quite amazing. Nobody even comes close to that including Air Europa if you even added into IAG. So, it's, I think it's great. I mean, I think Air Europa has sales of 2.1 billion, that's what I read, and I think TAP this year is going to be close to R\$3.5 billion.

Q - Michael Linenberg {BIO 1504009 <GO>}

Oh, wow.

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

So we're significantly bigger, the price that was paid. There's not equivalent to -- maybe the debt is a little bit different or something, but it certainly, it was encouraging for us. So we thought it was a great transaction. And it's interesting the antitrust implications of that, with both the carriers being in Madrid, but, obviously, I feel confident that that's going to

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be approved. So certainly opens up -- it makes our investment more valuable, no doubt about it. We're pretty excited about it.

Q - Michael Linenberg {BIO 1504009 <GO>}

Yeah. No, absolutely, it's great to see another marker in the marketplace. Anyway, good job this quarter everyone. Thank you.

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

Thanks, Mike.

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

And just remind to everybody that if you were to take the shares at Azul and sort of the convertible and all that, it's about 48% in TAP. So it's a significant account. It's by far and away the largest shareholder. So that's -- so when you talk about those numbers, you can take about half of that and that's what Azul's value in TAP shares.

Operator

Our next question comes from Dan McKenzie, Buckingham Research.

Q - Daniel McKenzie {BIO 15071178 <GO>}

Okay, thanks. Few questions here. Abhi, I'm wondering if you can talk about the velocity of demand that you've seen over the past couple of months. And what I'm getting at is we've had some pretty big developments in Brazil, including the passage of pension reform and it seems the privatization of state-owned companies has picked up here. And I'm just wondering what does that all mean for Azul? Are you seeing a more confident consumer or a less confident consumer? I'm just wondering how that all filters down to Azul.

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

Yeah. Hey, Dan. Yeah, I mean, we felt pretty good about demand. Obviously, we reported our October traffic yesterday, was very strong, strong internationally and very, very strong domestically. I think the industry is feeling pretty good about it overall, combining that with good capacity discipline. Good air discipline as well, not seeing too many strange things or aggressive things on the corporate discounts and the private fares and all those kinds of games.

So, yeah, I think that the corporate demand has been good the second half of the year. We're expecting now to have -- October was pretty good. October last year had elections, so we actually had a good comp as well for October. And November we have a very difficult comp, but November has started out well also. So certainly, I think on the domestic front, we're seeing strong numbers, and I think the numbers you will see from our friends in the domestic market are going to be good as well. So certainly, reasons to be optimistic here on the domestic side.

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

And, Dan, just, just to highlight and -- this pension reform is a big deal for Brazil and the states will be included soon. And one thing that we saw, as we saw Brazilians going to the streets asking for pension reform, that's unheard of in Latin America and people pushing for it. I think there's a newfound optimism in the country. I think the economic team and the ministers that are in place right now are doing all the right things for Brazil and Brazil is headed very much in the right direction. The fact that we're seeing this demand and our flights being full, enable to add this capacity before Brazil takes off, right, I mean, we believe that Brazil will start to grow again over the next couple of years. And we're really poised to take advantage of that growth.

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

Yeah. And just to reiterate, Dan, I mean, this was our second best ever third quarter RASK in the history of Azul and we just missed it by 0.5%, so on by far our largest ever ASKs. And so, that gives you an idea of kind of the demand is there for this capacity.

Q - Daniel McKenzie {BIO 15071178 <GO>}

Yes. Yeah. And then just a follow-up here on the cost side, Alex, I'm wondering if you can just clarify the pressure, the FX pressure that put on CASK ex-fuel. So, if we could just look at costs or CASK excluding fuel on an FX-neutral basis, what would that have looked like in the third quarter?

A - Alexandre Wagner Malfitani {BIO 2519089 <GO>}

So that's the, it was a unique quarter, Dan, in which the average FX rate was fairly flat year-over-year. But the final FX rate, the end of quarter FX rate was pretty big year-over-year and also quarter-over-quarter, right. For operating expense, the average FX rate is more of a good indicator as to how our expenses are affected by FX. And so, year-over-year I don't think FX is as big of either a headwind or a tailwind for operating expense. There was some help from oil prices, right. So fuel prices in dollars were down, and that helped. But even if you adjust for FX, which was we didn't -- which didn't have a lot of effect, fuel and the payroll tax, we did see a decrease in CASK. So, what we call normalize CASK, normalized for these kind of out of control -- out of our control factors, our CASK would have gone down by about a 0.5, right. Which is just the natural result that you would expect from our up gauging, right, the fact that we're bringing in aircraft that has essentially the same trip cost or lower trip cost, but a lot more seats, right, which naturally reduce CASK, right. So I think this quarter, we didn't talk too much about the normalized CASK because the normalized CASK, which we always point to -- to try to control for all these macro factors, it was pretty similar to the accounting CASK, right. So 1% 1.5% reduction, I think that tells the story of what's happening with our operating expense.

Q - Daniel McKenzie {BIO 15071178 <GO>}

That's right. And if I could just squeeze in one last one here. The 500 departures with the EIs, it would be helpful to know what are the revenue are the flying that is, because, I mean, the way to think about that obviously is you've got a chunk of revenue. I don't know if that's 20%, 10% or 30% where you're going to see margins improve. But I think if you

can help size the part of that margin improvement story, that would be helpful. Anything you can share there.

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

Yeah, Dan, I'll get back to in the exact number, but these departures are in our hubs. So in Viracopos, for example, we fly 11 times a day to Curitiba or 10 times to Porto Alegre and things like that. In Belo Horizonte, in Recife, in Cuiaba. And so, a lot of big corporate markets that have higher than average yields, higher than average RASK. And so, it would be a higher than average for sure revenue representation than just what the ASKs are. So because these are our highest yielding corporate markets with the high frequency. So this is the exact number, but it will be a higher representation in terms of revenue than it is in terms of our ASKs. So it's going to be very significant when it comes down to our bottom line.

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

Yeah, But again, it's just, the ramp size, it's not just the revenue side. Abhi is talking about the revenue. It's the cost side. So, if you take 500 flights and you take 15% or so off of that cost to all those 500 flights, that's really significant. And then you add the revenue on top of that, because you have 18 more seats. We've got some numbers internally that are pretty eye popping and obviously most of the new look quite significantly on our margins and that's why we're expediting the EIs as quickly as possible and taking delivery to the E2s as quickly as possible as we've been talking about for few quarters now. But now we're actually doing it.

Q - Daniel McKenzie {BIO 15071178 <GO>}

Understood. Thanks for the time.

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

Thank you, Dan.

Operator

Our next question comes from Andreas Sevaruto [ph] UBS.

Q - Unidentified Participant

Hi, thank you very much for taking my question. I would like to understand better the depreciation decreased quarter over quarter. We saw that depreciation decrease at around 5% quarter-over-quarter, but at the same time, we have seen increases in PP&E and rent payments. So if you could provide some color on that would be very helpful.

And I just have one second question regarding the competition outlook on regional routes, especially after the start of operations of (inaudible). That's it from my end. Thank you.

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

Great. I'll start with the depreciation and Abhi will take the regional routes. Yeah, so, depreciation as you can see obviously went up year-over-year. Some of it from the fleet transformation, but more of it for maintenance. The truth is, it kind of takes a while for all our new aircraft to really start impacting depreciation significantly. The way IFRS 16 works, you're taking the present value of all the payments that you're going to have over the course of 12 years, or 144 months, you're calculating the present value of that using our discount rate, which is fairly, it's higher than the risk-free rate. So that gets you a smaller number and then you divide that by 144, you can do the math and you'll see that as every -- each aircraft gets added, it doesn't really impact depreciation all that much. It impacts that more significantly because of the debt takes the full brunt of the of the present value.

And also it effects leverage as we always talk about because you get the leverage, you get the debt impact on the leverage, but you don't get the EBITDA generation yet, right. That will come over time. Now, so you shouldn't expect a huge growth quarter-over-quarter, certainly not as we're seeing in the growth of ASKs for example. Because like I said, it takes a while for these new aircraft to start impacting depreciation.

Also this year what we did is because we have the change in IFRS, we have all these new aircraft coming in, we were -- we made a small change to the timing of when we recognize -- when we start recognizing the depreciation of the new aircraft. That change was all within the year of 2019, right. So that's why you're seeing Q2 higher than Q3 because we've kind of changed that policy in Q3. So what really means is Q1 was a little bit higher than with this new policy, Q2 a little bit higher than with this new policy, and then we reverse that. We are in Q3. And that's why you see the reduction in Q3 versus Q2. But it's all -- when you look at the full year number, it's all consistent.

Q - Unidentified Participant

Okay.

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

And regarding the question about the regional route, yeah, we have Passaredo just starting, some regional route outside of Congonhas. So in terms of our direct overlap with them, we still have very, very little direct overlap with them, I believe, maybe one or two routes total. We're not seeing any impact from their flights in our numbers. It represents a very small percentage of our network. And so, it's not something that is a big impact that we are seeing, not something we are noticing on a day-to-day basis. We're watching it. And -- but in terms of the impact we're not seeing anything significant to report or to notice.

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

I just want to put it in perspective, I think Passaredo had 5 ATRs to 6 ATRs and MAPI [ph] had 2 ATRs to 3 ATRs. So you're talking about in total 7 ATRs to 9 ATRs and a lot of them they dedicated to the Congonhas Airport to fly the new schedule, exit a lot of routes that MAPI was flying in Amazonas. And when you fly in Congonhas, it's important for you to keep the schedule there and a lot of the markets that they fly are local markets that we

don't compete with them on. Like for example, Congonhas, they have been on Preto [ph] and I think they have direct competition with LATAM on that route. But we don't fly it. And so very, very small airline overall. Even after combining the two airlines, it's very small. And so, it's pretty insignificant in the big scheme of things, and I think -- keep in mind, we're taking 12 aircraft in the fourth quarter that are 3x the size of their largest aircraft. And so, it's pretty small relative to the business that we have.

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Q - Unidentified Participant

That's very helpful. Thank you very much.

Operator

Our next question comes from Stephen Trent, Citi.

Q - Unidentified Participant

Yes, hi. It's actually Brian Roberts on for Steve Trent. Thank you for taking the question. If we could go back to your stake in TAP through the converts, is it fair to say that Azul could monetize this holding if approached by a strategic suitor or a cap or decide to IPO?

A - Alexandre Wagner Malfitani {BIO 2519089 <GO>}

Of course, that's why we own it. I mean, we own it as an investment and we think it's certainly -- it's continuing to increase in value. As we -- as we mentioned, as John mentioned in this script, TAP is undergoing the same kind of fleet transformation that we're doing here. They're replacing the A330-200s for A330neos. They were able to -- they only have 15 that are this year. They'll exit the year with like 75% of their new generation airplanes on the wide-body fleet. And then they are starting a narrow-body. They start to find the A321LR which is used to be called long -- A321 stood for a long-range but we changed it to Lisbon range because it kind of works best for Lisbon and any the other capital Europe until the XLR comes along.

So we start flying that to BeLague and started flying it to Washington for the off-season. We're seeing expansion on margins with those airplanes. So things are looking great with TAP. And so, we're excited about our investment there and we're also excited about the strategic value of having this joint venture that we announced today as it is approved by the Board yesterday. So the ability to kind of -- there's going to be huge synergies between both of us being able to coordinate schedules and coordinate fares and do all those things.

But also it's an investment. And if we -- some of the invest in it or purchase of it, we certainly have upside for all of that because of our ownership stake.

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

Yeah, I think it's important that having the commercial agreement and the joint venture in place means that we can monetize the asset and still have all the strategic value associated with it. And so, that's why the sequencing is happening. And so, it's very

important for us to get the commercial joint venture in place before we talk about a few of the alternatives for liquidity that you addressed.

Q - Stephen Trent {BIO 5581382 <GO>}

Great. Thank you. And then if we could just switch gears, given your partnership with Mali, is it possible that we might see other partnerships with other e-commerce companies like Amazon, etc.? Thank you.

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

We're not naming Amazon or any of the other players right now, but we are significantly investing in our logistics network in Brazil, right. And so, we'll continue to invest. A lot of our management time is focused on it. And I think you'll hear a lot about this over the coming year or so. And so, we're very excited. It's a new phase in Brazil and the fact that we can deliver packages in 3,700 municipalities in the country, it's very powerful, our network is our greatest strength, and we're going to leverage that as much as we can in the e-commerce business.

Q - Stephen Trent {BIO 5581382 <GO>}

Great. Thank you.

Operator

Our next question comes from Josh Milberg, Morgan Stanley.

Q - Josh Milberg {BIO 19336060 <GO>}

Good afternoon everyone and thanks for the call. You guys have already covered a lot of ground today. But I wanted to ask about the issue of hidden assets that Alex had touched on at your Investor Day and just the potential for prepaid maintenance expenses to go down longer term. I think it's maybe not too surprising to see that that line in your balance sheet was up this quarter. But I was just hoping you could give a little more perspective on how it could evolve in the next few years and -- or how we might project that upside. Thanks.

A - Alexandre Wagner Malfitani {BIO 2519089 <GO>}

I think the way to project it, Josh, is I think our fleet plan is probably a good proxy, because the payment of maintenance reserves is by and large a phenomenon from our old EI leases, right, and that's why we're confident that they will go down over time because as the EIs leave and they will leave, it's just a matter of time. We will see that line going down. Now, we are -- the reason why it may go up or down until then is more of a question of the maintenance events that the EIs will go through or not, right. In some quarters where you have a lot of maintenance events we may kind of dip into that balance to pay for the maintenance events. And then if there is a quarter with not a lot of EI events that we may have the payments for the maintenance reserves that go together with the lease payments, but not the drawdown, right. So I think the way you will really as - - we haven't had a lot of EIs leaving, but we're very excited about the recent progress

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that we've made with the EIs, because we sold one in Q3, we sold one in Q4, we have the MOU to start accelerating their exit and that's when you're going to see that balance start to come down. The other thing that drives that balance is FX, right. We -- not only to (inaudible) in terms of prepaid cash has already left the company but that balance is all in dollars. And so, as the currency fluctuates, you will see that balance going up and down as well.

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

And, Josh, one of the benefits you get with the submission of these 32 EIs, is that the redelivery conditions now transfer to the new lessee, right. And so that's one of the benefits that you have is they use the aircraft for the remaining term of the lease responsible for their portion of the of the return conditions.

Q - Josh Milberg {BIO 19336060 <GO>}

Okay, very clear response. Thank you very much.

Operator

Our next question comes from Pablo Monsivais, Barclays.

Q - Pablo Monsivais {BIO 17389900 <GO>}

Hello. Hi, guys, congrats on the results. I have one follow-up question, can you please share with us what is putting some pressure on unit revenues in the third quarter and probably in the fourth quarter of 2019 that is causing your lower margin guidance despite better unit cost performance? Is there anything incremental here that we should be aware of? Thanks.

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

Hey, Pablo, Abhi here. Yeah, so as I kind of talked about earlier in the call there were sort of two effects that are putting pressure on RASK, on a year-over-year basis. One is the higher base from last year. We had a record months almost every month last year second half of the year, including September, October, November. But the biggest effect that we're having is the effect of the aircraft mix. The A320s are flying double the average stage length, and they are 50% bigger. So on an absolute basis, that aircraft has a lower absolute RASK than the other aircraft.

If you look at our RASK for each and every equipment type they all actually went up year-over-year. Our A320s went up in capacity 100% and our RASK was up more than 5% on the A320s. But, however, because they have a lower absolute number as they become a larger and larger percentage in terms of ASK waiting in the network, that brings down the overall RASK of the airline.

And so, that's why we're looking at 3Q and 4Q RASK of close to zero. Close to zero actually means that we are recovering 7 points to 8 points of RASK, that's a headwind due to the the aircraft mix. So I actually think revenue is doing very well. We're able to

implement the capacity and the demand is there. As I said, this is our second best ever third quarter in the history of Azul with by far the most ASKs in the history of Azul. So the revenue environment is strong. We're just having the effects in terms of year-over-year RASK due to the strong base last year and the effect of the aircraft mix.

A - Alexandre Wagner Malfitani {BIO 2519089 <GO>}

And I also think we never promised to forever increase RASK. In fact, these new generation aircraft can allow us to reduce RASK over the coming years and expand margins. I mean, that's the whole key of bringing in a new aircraft has unit cost that are 25% and 29% lower than our actual aircraft. It's really going to strengthen the network as we move forward. And so, the fact that the market was able to accept all the capacity that we put into it and to have RASK, up 1.7% on a stage length adjusted basis, I think it's a strength of the network that we have.

Q - Pablo Monsivais {BIO 17389900 <GO>}

Of course. Perfect. Thank you very much.

Operator

(Operator Instructions). Our next question comes from Lucas Barbosa, Morgan Stanley.

Q - Lucas Barbosa {BIO 20835372 <GO>}

Good afternoon everyone and thanks for taking my question. So my question is on the A321neos, can you walk us through the strategy for these aircraft? I can imagine they will be allocated in the highest density routes in the domestic market, but any color you can give on where they will be allocated will help a lot. Also, if you could give any color on how their unit cost compared to the A320neos, that would be great. Thanks very much.

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

Okay. Yeah, so in terms of the -- where to put these aircraft, I'm obviously very excited to have this airplane into our network. One of the unique benefits that we have in our network is we have a hub in Sao Paulo in Campinas. We have a hub in Belo Horizonte. We have a hub in Recife, all of which are very meaningfully sized hubs. Hasifi [ph] approaching 80 departures a day. Belo Horizonte approaching 100 departures a day to 45 destinations, and of course Campinas with 150 departures a day.

So just connecting the hubs to each other is going to be the first mission of the A321 and this is not only helps the economics of those routes but it helps the economics of all of the other routes that connect. So we're able to drive a lot more connectivity with each one of those flights than they were before. Similar to what we did with the E1 to the A320, we can now do with the A320 to the A321s.

So the first job is just to connect the hubs to each other. And then, of course, we have our focus cities like Cuiaba, like Belem, like Curitiba, like Porto Alegre, that they themselves have connectivity within them. So that could -- so there is lot of opportunity as well.

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So given how broad our network is and how broad the platform is throughout the different country, throughout the country. there's just a lot of opportunity for us with the A321s. In terms of the cost economics, we're very excited. We think that the trip cost of the A321 is just going to be slightly higher than that of the A320 and that's with 40 additional seats, so you're going to see additional unit cost leverage for us as we use this aircraft. It's going to help us lower our unit costs further. And given the strength of the network and how broad the network is, I'm very confident that we can protect the revenue and actually improved revenue across the network with this airplane.

Q - Lucas Barbosa {BIO 20835372 <GO>}

Okay. Thanks very much. That makes a lot of sense.

Operator

Our next question comes from Sav Syth, Raymond James.

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

Savi?

Operator

Excuse me, Sav, your line is open.

Q - Savanthi Syth {BIO 17476219 <GO>}

Sorry about that. Hey, I just had a follow-up on the annual review for the EI. Just how quickly do you envision those aircraft leaving the fleet versus kind of the prior expectation now that you have this?

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

Yeah, Savi, there is as many as 10 next year alone in 2020 and then we have our natural lease returns as well. And, as Alex said, we've also sold one in the fourth quarter of this year. And so, it's going to be a significant transition out of the EIs. And so, as you look at 2021 to 2022, I think you're going to see almost all of our EIs exiting our fleet in that period of time.

A - Alexandre Wagner Malfitani {BIO 2519089 <GO>}

Yeah, and Savi, one thing that I think is good to clarify, thanks for the question, is the fleet plan that we have on our institutional deck, that's our expected delivery time, right. That's not the contractual time. So the success that we've had, it may accelerate one year and -- but a lot of it is already incorporated. So I think, like John said, there is such a big exit in 2020 that maybe we're going to kind of beat the fleet plan in 2020 but that's already an objective of offers, right. That's not the contractual delivery schedule. It's actually what we believe we can accomplish with all the marketing effort that we are doing in order to sell our owned EIs and to sublease the least EIs.

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

And Embraer has the ability to pull forward our deliveries.

A - Alexandre Wagner Malfitani {BIO 2519089 <GO>}

For the E2s, correct.

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

For the E2s.

Q - Savanthi Syth {BIO 17476219 <GO>}

Makes sense. And with the Airbus, do you expect some catch-up next year or do you expect some of these delays kind of continuing into the following year?

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

It's got to get better, right? We've been hearing that for a while, but we expect them to get to get back. I think the A321s have been a lot more delayed than the A320neos. But hopefully, we're down to a two-, three-month delay as opposed to six months delay is what we've seen, so.

A - Alexandre Wagner Malfitani {BIO 2519089 <GO>}

I mean, pretty flexible I mean, if we have to get rid of the E1s quicker, even in 2021, they can give us more than two deliveries to speed that up even quicker. So we're working really hard to do that not just with this MOU, but with others as well.

Q - Savanthi Syth {BIO 17476219 <GO>}

Got it. All very helpful. 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>}

Thanks for joining us today. We appreciate your support and look forward to talking with you over the next couple of days if you have further questions about our results. Thanks everybody.

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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