Q2 2017 Earnings Call

Company Participants

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

Other Participants

- Catherine O'Brien, Analyst
- Daniel McKenzie, Analyst
- Pedro Bruno, Analyst
- Savanthi Syth, Analyst
- Stephen Trent, Analyst
- Victor Mizusaki, Analyst

Presentation

Operator

Good morning everyone, and welcome to Azul's Second Quarter 2017 Results Conference Call. My name is Natalie 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 a 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.

Andrea Bottcher {BIO 20316630 <GO>}

Thank you, Natalie. And welcome all to Azul's Second Quarter 2017 Earnings Call. The results have been announced this morning, the audio of this call and the slides I will 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. During the course of the call, we will discuss non-IFRS performance measures, which should not be considered in isolation. For reconciliation of these measures, please refer to our earnings release.

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

David Gary Neeleman {BIO 687871 <GO>}

Thanks Andrea. Thanks everybody for joining this morning. We are excited to announce our second quarter results today. In a really traditionally weak quarter, we achieved record second quarter earnings. And first of all, I'd like to thank our crew members for doing such an outstanding job. There's no way, this Company would be in the position where it is today without the dedicated effort of more than 10,000 people that serve our customers every day and those that are behind the scenes, taking care of our crew members. So a huge thank you for them.

I think what this shows, as I said, the second quarter is a really traditionally weak quarter for the industry in Brazil. But we have a strong operating -- a really good operating profit, shows that we have a resilient business model with more stable earnings profile throughout the year. And certainly we're looking forward to now the third and fourth quarter.

As you can see, on slide three in our presentation that we gave you, we grew capacity in the second quarter by 18% and our revenue increased by 19%. So it's amazing to see we can increase capacity that much and the revenue can follow along. We even actually increased our load factor year-over-year.

So our market expansion strategy is working. We continue to add the low cost A320 that are really bringing in and are low cost and you'll see how that's affecting our cash going forward. We continue to build Brazil's largest network. We've added 11 cities since June of last year.

If you go to slide three, back to slide three, all those red dots that you have on that slide were all cities that we successfully added over the -- since June of last year. So we had an operating margin of 6.1% and EBITDAR margin of an incredible 28% really which cements us as -- certainly confirms our position as the most profitable airline in Brazil.

We also ended the quarter as the most capitalized airline in Brazil where we're solidly liquid with 3 billion in cash representing 42% of our last 12 months revenue. We also had highest on-time percentage of any other airline in Brazil in the second quarter with an 86.4% on-time percentage. So we're delivering great -- a great product to our customers.

And that obviously is evident in the fact that, Skytrax, just awarded us for the seventh time, seventh year in a row, the Best Low Cost Carrier in South America. And for the second time in a row, the Best Staff in South America in all of South America, which really shows that our people are doing a fantastic job of taking care of our customers.

All of that, on top of our third in the world ranking at TripAdvisor which came out three months ago. So we're very pleased about that. We don't do this for awards, but it's nice to get the recognition for our crew members.

I'm also excited about the recent management changes that we've made here. John Rodgerson, he is our new CEO. I worked and known him for 15 years. He made the decision to leave JetBlue and come down to Azul and help found this company. He is one of our founders. He is very passionate about this business and he is going to do a great job as CEO.

Alex is also a founder. Alex Malfitani, he is our new CFO and he is going to be fantastic in that role and he has worked with John since the beginning as well. So they work really great together. Then I think, well, a lot of comments on the road show were -- are all the Americans leaving? This certainly proves that that's not the case. John is committed and will be here for a long time to come as the new CEO of the airline.

It's also great to have Antonoaldo Neves move to TAP. As you know, we have a significant investment and upside in TAP, and so, it's good to have him over there and he's a great talent and he will do great for TAP in his position.

So we continue to be on track to create superior value for our shareholders, that's very important to us and we have a differentiated business model and a great management team. So we're very excited about the business. I think -- and doing all this when Brazil still hasn't recovered. Yeah, it's still difficult times in Brazil, but now you can only imagine how things would change if Brazil actually recovers one day.

So with all of that, I will turn the time over to John Rodgerson to give you more detail on these numbers that I've shared with you so far. John, it's all yours.

John Peter Rodgerson {BIO 17734009 <GO>}

Thanks David and good morning everyone. As David mentioned, as you can see on slide four, we had a very strong quarter this year with an operating margin of 6.1%, six margin points higher than last year and an EBITDAR margin of 28%, one of the highest in the industry.

I'm very proud of our CASK, ex-fuel performance, which decreased 8.1% in the quarter, while total CASK decreased 4.9% and that's with an 11% increase in fuel prices. This reduction was mostly due to the introduction of the A320neo's in our fleet, which have roughly 29% lower unit costs. We also reduced our financial expenses by 60 million by paying down more expensive debt. Over the second half of the year, some of the debt prepayment penalties will expire. So we'll continue to de-lever and reduce our financial expenses going forward.

Moving on to slide five. You can see our revenue performance in the quarter. The fact that we're the only carrier in 73% of our routes, allowed us to grow double-digits in the second quarter and at the same time increase unit revenue by 2%. This increase is even more meaningful considering the 9% increase in stage length. Average fare also increased 8% to BRL280 and our load factor increased almost 200 basis points.

Moving to slide six, we talked a lot about this on the road show, which was our margin expansion strategy. I want to go through each of these pillars with you, just reminding everyone on the call what these are. First with the A320neo, updating our fleet, A320neo aircraft, which has 56 incremental seats, essentially the same trip cost and 29% lower unit cost.

The second pillar was expanding TudoAzul, our loyalty program, which currently has 7.6 million members. And the third pillar, was increasing our ancillary revenues through our cargo business which grew 49% year-over-year in the second quarter, our packaging business and our initiatives to start charging for bags and unbundling the product. As you will see in the next few slides, we are successfully executing on each of these pillars and that's with the macroeconomic backdrop, as David mentioned, that hasn't yet started to improve. Once Brazil starts growing again, we are very well-positioned to benefit from improved macro scenario.

Moving to slide seven, we continue to be impressed with the performance of our A320neo. They have amazing productivity. With an average utilization rate of 14.2 block hours per day, we are seeing strong margin expansion on the route they currently serve.

Our A320neos have been deployed on our longer-haul routes replacing the Embraer-195, which is more suited for a high frequency business market. As I mentioned previously, the neo -- with the neo we're able to add 56 incremental seats at practically no extra cost, a very low-risk growth strategy moving forward.

The introduction of the larger aircraft in these longer haul routes allows us to drive increased connectivity throughout our network. As we widen the pipes on these trunk routes, these aircraft will also help us grow our ancillary revenue, specifically in TudoAzul cargo and our travel packaging division.

Most of our capacity growth this year is coming from the A320neo. Over the next few years, we expect to grow through -- to go through a significant fleet transformation process as we replace older generation aircraft with next-gen aircraft, namely the A320neo and the Embraer E2 starting in 2019.

Moving on to slide eight, you could see the performance of our loyalty program in the second quarter. Our loyalty program, as I stated previously reached 7.6 million members. This represents an addition of 1.4 million members over the last 12 months. We increased gross billings ex-Azul by 48% during the last 12 months with the majority of this increase coming from sales to our banking partners further increasing our share of the Brazilian loyalty market.

And as we stated many times to you previously, unlike other airlines in Brazil, TudoAzul is a 100% owned by the company. This means that we have no tax inefficiency and benefit 100% from the cash flow generated by this high growth, high margin business going forward.

Moving onto slide nine, Azul is a leader in the industry with charging for bags. We were the first ones to implement, the bag fee starting on June 1st. We implemented the new baggage policy with minimal operational or customer disruption and are seeing bag fee revenue ramping up as expected. We are up selling by charging BRL30 in advance for the first bag online and BRL50 at the airport. Charging for bags is just the first step of unbundling of our product. Bag fees and product unbundling will be an important source of ancillary revenue in 2018 and beyond.

Moving quickly to slide 10, you will see that our strong network and great customer service allow us to attract high yield business travelers. Although we had an overall market share in terms of RPKs of 19% in the second quarter, our market share in terms of corporate revenue according to ABRACORP, the Brazilian association of corporate travel agency is as high as 30%. This is further evidenced on the graph on the right, which shows our pricing power advantage. This again mostly thanks to our network, which has less than 30% overlap in terms of ASK with our competitors.

Taking a quick look at balance sheet on slide 11. We ended the quarter with a solid liquidity position of 2.2 billion. Including receivables, our total liquidity position reached BRL3 billion at the end of the quarter representing 42% of last 12 months revenue, certainly one of the highest in the industry.

We amortized 200 million in loans during the second quarter resulting in a debt position of BRL3.6 billion and a leverage ratio of 4.5. By the end of the year we expect to reach a leverage ratio closer to 4. With the proceeds of the IPO received in April of approximately BRL1.3 billion, our cash position was significantly strengthened. Going forward, we will be able to lower our borrowing cost by paying down our more expensive debt.

In addition to having the lowest leverage in the country, we also have much lower exposure to foreign currency. Only 46% of our debt is denominated in US dollars and virtually all of our working capital debt is denominated in local currency. As you look at the slide 12, we are now along dollar, which is very unique for a Latin American airline.

Our dollar-denominated assets, namely our cash that we hold in dollars, deposits on aircraft and maintenance reserves abroad and our investment in TAP now surpass our dollar-denominated liabilities by over BRL500 million. If you add to that the aircraft engines and spare parts, which are not restated to the exchange rate every quarter, but are US-dollar denominated assets, we have more than twice the asset US dollar compared to our liability. This is a major development, which reaffirms our position as the airline with the best balance sheet in Brazil.

We're very excited about the quarter and with that, we'll turn it over for questions.

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 Michael Linenberg with Deutsche Bank.

Q - Catherine O'Brien

Good morning, gentlemen. This is actually Catherine O'Brien filling in for Mike. I was wondering, can you speak a little bit about how the roll out of bag fees is going, you know, it sounds like it's in line with expectations, maybe just give us little more color on what the take rates are like and what kind of growth we could expect to see in ancillary revenue in the back half of 2017?

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

Hey Katy, it's Abhi. Yeah, so we started selling fares without baggage on June 1st, and initially we did it in market that we were alone, which is obviously a big part of our network. Gol came in on June 20, which rounded out the rest of the competitive landscape and LATAM was a week after that. So by June 27th, pretty much the baggage fares were implemented network wide for Azul Gol and LATAM.

As John said, the implementation has been very good, I want to thank all our crew members. It's a big change for Brazilian customers. But we've seen very little operational disruption and very little negative feedback. So currently we're selling two product fares. One is called Azul, which is without checked baggage, and one is called Mais Azul which has a 23 kilo per passenger allowance for checked baggage for BRL30.

If you buy the Azul fare and you show up at the airport with a bag for whatever reason, then you pay BRL50 at our counter or the kiosk or on the app. So the -- I don't want to be too specific, but we're seeing something like 50% to 60% of our customers buying the fare without checked baggage. And then we're seeing a relatively good percentage of those customers actually show up to the airport with a bag. And so, they could have saved BRL20 actually if they had bought up, but for whatever reason, they changed their mind or something happened and we're seeing a meaningful percentage of those customers then coming to the airport and checking a bag which gives us BRL50.

So, as John said, what's really interesting about this is that, it is just the start of unbundling. As akin in the US and in Europe, the typical things that come with unbundling are seat assignment, things like anticipate your flight, things like less points or no points for different types or fares. So those are the kind of products that we will explore in the second half of the year and into 2018.

It is ramping up as expected slowly, and so we feel good about the 100 million number that we gave you last time for 2018. That's really where we're focused on, this year we just want to make sure, the smooth rollout continues and the ramp-up happens as we expect.

Q - Catherine O'Brien

Okay great. Thanks for that. If I could just squeeze maybe one more in. How quickly are these A320neo flights ramping up and maybe just, in general, how are margin compared with -- on these flights compared to your system average? And then, is everything still going in line with expectations, now that we're starting to see capacity get added back between the US and Brazil after the seat-cuts made last year.

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

Yeah, so, Abhi can talk about the routes. But I think, I'm really pushing the team to get them as soon as possible to kind of, you know, what we're seeing today is far exceeding what we had actually thought. We were on the road show talking about this. Abhi had said, if we could snap our fingers and have 25 of them today, we'll do that.

We see that number is actually significantly higher than that. And so, we expect to have around 20 by the end of next year. But then we have eight today. And so, I'm actually pushing the team to see if we can move out some of the other airplanes quicker and bring them in faster. So it's top of our priority right now, and that's what we're really focused on. But just getting to 20 by the end of next year is going to be a great accomplishment and it will -- you will see it in our numbers -- will significantly improve our numbers.

I thought it was interesting that, I was running through, one of our competitors earnings release and it showed, on a per-ASK basis it showed how we have a really high rental cost and really high maintenance cost per-ASK. They are totally right, we do, but that's upside for investors. I was going to put that as an exhibit in our presentation and use their source. We do, but that doesn't mean that, hey, we have small airplanes that fly shorter routes to bring us high revenue, and they were doing that on the longer route.

And now we're going to be able to put the right plane on the right route over the next two to three year, and that is going to -- that's what we're really excited about, that's what's really moving and having a sea change here at Azul.

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

Yeah, thanks David. And Katy regarding the margin, our seat cost, as we've said many times on these airplanes is going to be 29% lower than the Embraer-195 on like-for-like routes, we're definitely seeing that. On the margin I can't be too specific, but what I can say is that, we are seeing a unit revenue reduction significantly lower than that number. If it were not that much lower, it would have kind of affect our overall numbers more.

And so, we are seeing very, very healthy margin expansion in these routes. In terms of, is it going as expected? I would say it's probably going better than we expected in terms of the operation and as well as how it's helping the network, how it's helping cargo, how it's helping loyalty. And so, as David said, we're anxious to get these implemented and ramped up as soon as we can.

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

And Katy, I think it's important, we've needed these aircraft for a couple of years. And so, when we talk about ramping these in, these markets needed the larger capacity over the last couple of years. And so it's a blessing that we now have them in the fleet. But it is not a significant ramp-up that's happening because these markets needed 174 seats, not 118 seats.

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

And Katy, I missed your question about International. Do you mind saying it again please?

Q - Catherine O'Brien

Yeah, sure. So thanks for all that color too, that's great. Just on some of these routes we're adding to the US, we're starting to see capacity get added back, for instance, no, maybe that had impacted your projections at all or things are still going as expected?

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

Yeah, it's going as expected, you are right, some capacity is coming back. But the market, we think it's still strong, it's going as expected. As you know, we announced two routes on Friday, one is Belo Horizonte to Orlando and one is Belem to Fort Lauderdale, which David has been mildly encouraging me to do for a while now.

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

Finally.

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

It's going as expected, we're excited about them and overall we're happy with International.

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

Let me just say one thing about these Northern Brazil to Florida routes. The ability for us to kind of fly those airplanes still at 18 hours a day, or 14 hours a day going back and forth with the low cost, and what we've seen at TAP is, the high market share they have flying to Europe from the Northern Brazil cities. And we think there is a big opportunity. So this will be a good experience -- experiment for us to flying Belem to Orlando, people of North, they're going to love it.

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

Not have to come all way down to Sao Paulo to catch a flight to the North.

Q - Catherine O'Brien

Okay. Thank you so much for all the time.

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

Thanks Katy.

Operator

The next question comes from Savanthi Syth with Raymond James.

Q - Savanthi Syth {BIO 17476219 <GO>}

Hi guys. I was wondering as to follow-up a little bit on Katy's question. On the International side, I was wondering how much of your revenue International is today and what kind of unit revenue trends are you seeing between flying domestic versus international that's netting out to the (inaudible)

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

Yeah, hey Savi, we're not breaking out the, the breakout between domestic and international. The main reason being because the absolute numbers are different because of the aircraft size and the stage length, it can lead to incorrect conclusions if we try and do the math without having all the details.

What I can tell you is that, American said that, their Latin was up 43% in second quarter. LATAM just reported July, international, their international load factor was 88 or something like that. And so, international is strong. The unit revenues are up year-over-year.

As we come out of the crisis of last year, the strengthening of the local currency is definitely encouraging Brazilians to travel more to the US and Europe. So I think all of the airlines flying internationally are benefiting and reporting good year-over-year unit revenues.

That being said, we wouldn't have been able to have a PRASK up almost 2% year-over-year if domestic was terrible. International isn't that big to single-handedly carry us over the line in that way. So, our domestic has been hanging in there, it's stable. We're seeing solid numbers with the A320s.

I think as Gol said, there was acceleration of domestic demand in the end of second quarter, that is true, driven mostly by leisure, which makes sense given the dry holidays. It let into a pretty nice July overall for us. And now we'll see typically corporate revenue improve second half of the year.

So, international, it's strong, strong for everybody, strong for us. But that being said, single-handedly it's not enough, domestic had to be pretty solid as well and it is.

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

And the other thing about international is it's really helped our network, right. So that's why it so hard to, when you have over 50% of your customers connecting on your domestic network to go to your international network, in a lot of our markets then they're very intertwined and they help each other out, they're very synergistic.

Q - Savanthi Syth {BIO 17476219 <GO>}

Good going. Just -- sorry, just to follow-up on that corporate comment you made. Are you seeing the corporate demand recover or is it still too early to say how the corporate demand is going to be post the leisure demand season?

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

Yeah, I mean, I would say yes, but it's still a touch early. The first week of August is like the hangover week, people still coming back from July, getting settled in. And so, this week, next week, as we get into September, prior to the September 7 holiday are going to be important to get a feel for that.

What we are seeing and typically second half of the year is always better than the first half driven mostly by corporate at least until November. You have a lot of events, activity, you have a lot of expos, exhibitions, conferences that kind of stuff really help to drive that kind of demand. My sales team is telling me that we are seeing good momentum with events and those kinds of things picking up in the September, October, November timeframe.

So our fare discipline is good, capacity discipline is good, I think the table is set for a corporate recovery, given a macro that's steady if you work slow and steady. So it's a little bit early to say, but I think the conditions are right for a good corporate recovery. And I think we'll know more in next couple of weeks.

Q - Savanthi Syth {BIO 17476219 <GO>}

Very helpful. And if I -- John, if I may quickly ask you, on the working capital debt, could you elaborate a little bit on what's happening there?

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

Yeah, it's Alex here.

Q - Savanthi Syth {BIO 17476219 <GO>}

Yeah.

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

Yeah, thanks for the question. As you know, we had the very successful IPO in April. With that we got a lot of additional liquidity on the balance sheet. And with that, we had the luxury of having more options on what to do with our cash and with our working capital line item. So essentially, we just did a lot less receivable advancing in Q2, and we also had the ability to negotiate with suppliers to advance payments in exchange for very favorable commercial terms and better conditions.

And so, with that, we saved over BRL20 million in interest expense. And if we had maintained the same sort of cash management policy as we had before, we would have had an additional BRL300 million of cash on the balance sheet.

Q - Savanthi Syth {BIO 17476219 <GO>}

Got it. Thanks Alex. Thanks guys.

Operator

The next question comes from Dan McKenzie, Buckingham Research.

Q - Daniel McKenzie {BIO 15071178 <GO>}

Hey, good morning guys, thanks for the time. Alex, I like to go back to your last point. So plenty of liquidity is a message we are getting this morning much better credit. Was the incremental 300 million in liquidity you just referenced, was that in reference to potentially some renegotiation and maintenance reserves. And if not, if you are able to potentially given your better credit status give some of that cash back, how much you think about giving some of that incremental liquidity?

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

Yeah, I'll start and I think John wants to add to that as well. So, the 300 million that I mentioned still is more receivable advancing. So as you know, we sell with the credit cards. And with that we build a balance of receivables, which are very easy to advance and -- sorry Dan, yeah. And so, but could we have plenty of cash on the balance sheet, we did not advance those receivables. Had we advanced them, we would have an additional BRL300 million on the balance sheet and we would have -- but we would have spent some interest to do so.

But in terms of the additional liquidity on the balance sheet, we're absolutely seeing an improvement in credit. We did renew a BRL200 million debt with one of our banks and we mentioned that on our earnings, we had very favorable terms. So lower interest rate and longer payment terms. And we are also working with all of our suppliers in order to get better conditions on maintenance reserves and cash deposits as well.

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

Yeah, Dan, I just think it's opened up a whole new world for us since going public. And so, once we brought the cash on the balance sheet, we're looking at -- we talked about a lot, we got about $2 billion -- BRL2 billion of debt on the balance sheet, which is good debt, which is aircraft debt. And then the 1.6, which is the remaining is that's what we're aggressively attacking.

We're looking at various options that are afforded to us and we'll be talking with you about that over the next couple of quarters. But you should have an expectation that that total debt number should be coming down.

Q - Daniel McKenzie {BIO 15071178 <GO>}

Understood. And then I guess the second question here is for you, Abhi, imagine there was a sharp fall-off in bookings that created a temporary revenue hole around May 19 around sort of the (inaudible) and the FX volatility that has surrounded that. Obviously, it looks like you're able to close it in the quarter, but I am wondering, what kind of -- what would have revenue -- what could have revenue been without that booking hole. And I guess I am just trying to get a sense of how big a revenue headwind you had to overcome in the quarter?

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

Yeah, hey, Dan. So, first of all, second quarter was a pretty tricky quarter overall. April we had -- Brazil had three consecutive long weekend holidays. And we actually had four consecutive four day weeks because we had three holidays and then we had some labor reform stuff and we had the strike on a Friday.

So it was hard for corporate demand to get any sort of rhythm in the month. And then as you say on, May, we had the JBS news. What I will say is that the demand drop-off, as much as I would like to say it was a big hole and we kind of made it up and there is potentially some upside there. But I would say that I think the demand was actually pretty resilient in the phase of that news. We've seen demand drop off much more significantly a year or 18 months ago in -- when news like that comes out.

This time, was it a distraction? Yes. Did it affect us for a week especially in terms of growth in corporates? Yes, it did. But it was not as steep as we have seen previously. I think that, it was pretty resilient in the face of that kind of news. So it did affect overall a little bit, it was a distraction for sure. Obviously, we prefer not to have that. In terms of the overall impact, it's hard to say, I mean June definitely, did perform better than May on a year-over-year basis.

So, there is some impact from there. In terms of RASM for the entire quarter, I don't know, I would say it's in the 0.5%, maybe something like that, just a ball-parking. But overall I would say that this impact was not as sharp, as perhaps you were imagining. It was little bit, it was more resilient than what we've seen before.

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

And Dan, you know, I had talked about this as well. The markets recovered significantly since May 19th when that incident happened. And what you're seeing in Brazil, well, you haven't seen a recovery yet, you're seeing stability. You're seeing the currency trading a pretty narrow band, we're seeing stable bookings. And so, again we're not here to claim that the recovery is in play yet. But we're very optimistic for the second half of the year. And the fact that the market digested the JBS news so quickly and got back to where it was previously, the news I think is a very positive signal.

Q - Daniel McKenzie {BIO 15071178 <GO>}

Pretty good. Thanks for your time guys.

Operator

The next question comes from Stephen Trent with Citi.

Q - Stephen Trent {BIO 5581382 <GO>}

Good day everybody and thanks very much for taking my question. Just two from me. I was first curious about what your thoughts are on the international side, you know, giving your, moving little closer to, and working more directly with Hainan Airlines and you continue to be, I guess, somewhat further integrating in terms of fleet strategy at least with TAP to Portugal. I am just wondering how your thinking has evolved, what's actually look like on a long-term basis?

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

Hey Steve, thanks for the question, I think, Hainan is a great partner, they put flight into Lisbon, which is fantastic for us. We are working very closely with TAP. And we are trying to get our fleet to be very similar to theirs, which gives us flexibility. And I think, having flexibility is a great competitive strength in this market. The ability to move assets relatively quickly across the group, and so, we've done that with -- we've proven to be able to do that with TAP, we've done that with Hainan. And I think that has allowed us to exit the crisis in Brazil a lot quicker from our competition.

And so, it's a competitive strength that we have that we can move a lot quicker and the more we align ourselves with our partners and I think the better. I'll let, kind of Abhi talk to the revenue side of it.

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

Yeah, hey, Stephen. What we said all along about international is, we want to fly from where we are strong to where our partners are strong. And so, that explains Viracopos-Orlando, Belo Horizonte-Orlando, Recife-Orlando explains Viracopos-Lisbon, Belem-Fort Lauderdale as well, JetBlue is very, very strong in Fort Lauderdale. We're building a little bit of a connecting complex there as well.

So, that's our thinking that hasn't changed. We still have plenty of opportunities within that space from where we are strong. We have multiple hubs in Brazil to where our partners are strong. Fort Lauderdale, Orlando, Lisbon and kind of where JetBlue, United and TAP are strong. So that hasn't changed. And that's kind of how we're seeing it, seeing it evolve the next couple of years.

Q - Stephen Trent {BIO 5581382 <GO>}

Okay. Very helpful, guys. And just one other question for me, kind of switching to the domestic market. Admittedly kind of a dumb question on my part, but when I think about at least some potential for the government to reduce jet fuel taxation on domestic flights, even though we tend to believe that if the fuel reduction does offer that you somehow lose your advantages on these regional routes at least from that I can see, it seems like a function of, servicing smaller airports with smaller planes and the laws of physics [ph] and not fuel tax policy, but I would like to hear your thoughts on that.

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

You're absolutely right, Stephen. It doesn't necessarily change the fact that we've got. ICMS agreements in a lot of the states because of the aircraft type that we fly, and we have the ability to serve a lot more cities and states than our competitors can, because they have one fleet type.

And so, I think overall the ICMS cap at 12%, is very positive for the industry. So, we're certainly supporting it jointly with ABEAR and that we've been working very closely, it got to vote this week. And looks like it's been postponed for a couple of weeks, but we'll be looking at that very closely. It might tighten the gap a little bit, because there is no -- if Sao Paulo comes down from 25 to 12. But overall, it's very, very positive from an industry perspective and we have no intention of losing our individual ICMS agreements.

And since we started doing these agreements, we've yet to have a governor in any state in Brazil remove the benefit to us, because it brings a tremendous amount of activity for their state and economic development for their state. And so, it's very important to them. Our flights are the lifeblood of these cities, and in some states we serve eight cities in their state.

And so -- and some of these were frankly are cities, we wouldn't fly if we didn't get the benefit. So, there is a bit of a trade-off there. It's not one, it's not completely benefit to us. But it's a win-win for the states and for us. And so any tinkering they do with these taxes, we still have the governors that are still on our side and making sure that we're going to be able fly to the cities they want us to fly to, that's kind of the underlying principle.

Q - Stephen Trent {BIO 5581382 <GO>}

Okay. That's very helpful. I appreciate the color there.

Operator

(Operator Instructions) The next question comes from Pedro Bruno with Santander.

Q - Pedro Bruno {BIO 19082978 <GO>}

Good morning, thanks for taking my question. If you could just give us some color on your guidance. I don't know if you can share with us what's the premises are underneath for FX and fuel on the guidance that you reiterated in this quarter? Thank you very much.

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

Hey, Pedro, we look at the forward curves, we're looking at the forward curve for both currency and fuel. And that's what we put in. So, if you just go to Bloomberg, we're fairly confident that we're going to be able to hit our guidance, and we're excited. Now lot of people asked us, are we changing it? We still got six months to go. We're working really hard and, we intend to deliver our guidance.

Q - Pedro Bruno {BIO 19082978 <GO>}

Okay, thank you.

Operator

The next question comes from Victor Mizusaki with Bradesco BBI.

Q - Victor Mizusaki {BIO 4087162 <GO>}

Hi, good morning. I have two questions here. The first one, can you give any color on how TAP is performing. And the second question, I think that Abhi mentioned a little bit about unbundling the fare next year. So, I don't know if you can comment a little bit more on what kind of service do you expect to charge?

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

Okay. So, first. Victor, this is, David, on TAP. TAP is doing well, great summer season, flights are full. The Brazil international recovery that we've seen is also something that TAP is seeing, planes are full, Europe is doing well. There is still a restructuring that needs to be taken there on costs. And so that takes a little bit of time and so that's a two or three year ongoing process.

And so we're very, very pleased with the revenues and feel very confident that the costs will -- are coming in and will continue to come in, it's not something that we can do quickly, but we're getting a lot of support from all the crew members there and everyone is working together. Everyone, you know, the government, us, those who privatize it, the crew members, everyone knows how important TAP is to Portugal. And so, we -- everyone is working together.

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

Hey, Victor. About the ancillary, I mean it's stuff that you've seen other airlines do. For example anticipate your flight, I mean, that's something that airlines around the world charge for. In Brazil, you can do that for free, that's something that maybe only customers paying their higher fares should be able to do. Seat assignments, Azul has not had a middle seat so far. So we haven't seen much value in charging customers for seat assignments, but with the A320s in the US, in Europe, customers absolutely pay for not having to sit in the middle seat. Things like points, if you want extra points or if you want a point on your purchase, maybe the promotional fare, the week-end sale fares, the discounted fares, maybe you get less points or no points.

So it's things that have been done around the world that other airlines are doing and they've had success with. Obviously, we want to make sure we do it in a very customer-friendly way, we want to do it in a way that doesn't upset our customers, doesn't upset our brand positioning and kind of the loyalty that our customers have to us and we have to them. But these are all tools and products that we'll look at over the next six months and into '18.

Q - Victor Mizusaki {BIO 4087162 <GO>}

Okay, thank you.

Operator

This concludes today's question-and-answer session. I would like to invite David to proceed with his closing statements. Please go ahead sir.

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

Great, well thank you all for joining us on the call today. We're, like I said, we're excited about our business. We feel we have a ton of upside going forward. Just like, once again to thank all of our crew members, particularly those that worked on this release and all the numbers and all this work, you're very much appreciated. And really it takes a lot of people to make a good airline and I couldn't be happier with the direction that we're headed. So, we'll talk to you next quarter and we continue to increase shareholder value, that's what we're here for. So thank you very much.

Operator

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