Q1 2017 Earnings Call

Company Participants

- Abhi Manoj Shah, Chief Revenue Officer Diretor Vice
- Andrea Bottcher, Investor Relations Manager
- David Gary Neeleman, Chairman & Chief Executive Officer
- John Peter Rodgerson, Chief Financial Officer and Investor Relations Officer

Other Participants

- Bruno Amorim, Analyst
- Dan J. McKenzie, Analyst
- Daniela Bretthauer, Analyst
- Matt Roberts, Analyst
- Michael J. Linenberg, Analyst
- Renato Salomone, Analyst
- Stephen Trent, Analyst
- Victor Mizusaki, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, everyone, and welcome to Azul's First Quarter 2017 Results Conference Call. My name is Roberta, 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.

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

Andrea Bottcher {BIO 20316630 <GO>}

Good morning, everyone. Thank you, Roberta. Thanks for joining us on our first quarter earnings call. The results that we announce this morning, the audio of this call and the slides or references are available on our IR website. Presenting today will be David Neeleman, Azul's Chairman and CEO; and John Rodgerson, our CFO. Our senior leadership team is 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 change. Also during the course of the call, we'll discuss non-IFRS performance measures, which should not be considered in isolation. For a reconciliation of these measures, please refer to our earnings call.

With that, please, David, would you like to proceed?

David Gary Neeleman {BIO 687871 <GO>}

Thanks, Andrea. Thank you, everybody, for joining us this morning for our first quarter earnings call. This is an exciting time for Azul, given the recent IPO. I'd like to start by thanking our crew members at our company. Their incredible dedication of taking care of our customers everyday really is the real reason that we're all here today because of their great service and our customers returning has really helped our growth over the last eight years.

I think what's demonstrated by this is, last month, TripAdvisor actually on, I think, the day of our IPO, came out with the top rankings of all the airlines in the world, and Azul was number three just behind Emirates and Singapore. And that was particularly meaningful to us because that's a survey that's actually taken by consumers, people who are actually are buying their product day-to-day as opposed to some of these other awards.

We also were named the number one best on time performance airlines in South America over the last 12 months through March 31, 2017. So, I can't say enough of gratitude to our crew members and for the great job they're doing.

If we go over to page 5 - slide 5 on the presentation, you can see our route map, and all the places we fly. We have more than 100 destinations, which is nearly twice the amount of any other airline in Brazil. And we are the only airline that flies on 72% of our routes. Now, if you add that to the routes where we have a frequency advantage, that's a total of 87% and we'll show you in a subsequent slide how that helps us.

We also - we have listed their - kind of our growth plan going forward is, we've got some new destinations. So we just started flying listed on that page. Also we have some upcoming destinations. And as we've said before, we intend on adding 30 new additional cities over the next five years or so. And all of these 30 cities will be cities where there is no airline service today. So that's really a huge part of our growth going forward.

Now, going over to slide number 6, you can see that the strong network that we have serving twice as many routes as our nearest competitor, this great service allows us to attract really high-yield business travelers, who really value the convenient and frequent flights. Although we only have 80% market share in terms of RPKs, our market share in terms of corporate revenue, which is, of course, the highest yield in traffic that there is according to ABRACORP, which is the Brazilian Association of Corporate Travel Agencies, is 29%. So you can see that on that graph.

Also, if you go to the other side of that graph, you can see what that leads us to in average fare. So, we have an average fare of higher than any of our other competitors. And that's because we have less than 30% overlap in terms of ASKs on our route system, which allows us to get higher average fares.

Going to page 7, you can see our fleet composition going forward. And one of the big stories of Azul is that we fly the right aircrafts for each of the markets we serve. And this is a huge competitive advantage for us. Over the next five years, the E-Jet will continue to be the backbone of our operation mostly targeted around business routes, high-frequency business routes. The ATRs will be our choice of aircraft to explore these 30 new cities that I talked about earlier. And they'll serve, of course, the lower density and shorter routes as well.

Now, we're continuing to add A320s. We have eight in the fleet today. We're going to add between six and eight deliveries a year. And so, this will drive some growth that we had going forward. As you can see, you'll see later in our guidance that we're going to grow between 11% and 13% in 2017, but this will come primarily from upgrading as we move the A320s into the routes that are currently being flown by the E-Jets.

And this, I mean, ideally this will give us increased margin expansion going forward. Let me just flip forward to page 7 – I can give you – slide 7 talks a little bit more in detail about what the A320neos are doing for our route system.

Now, if we have flights – the shortest routes, of course, are Embraer and ATRs and the lowest density routes, the medium routes, the business travel routes where we have high frequency flights that are under two hours were flown primarily by the Embraer 195s. And now, as I mentioned, we're starting to put the 320s on flights that are more than two hours. And these aircrafts, as you can see on this graph here, have a 30% unit cost advantage over the rest of our fleets.

Now, really importantly for this is that by adding this – these are very popular kind of leisure destinations flying to the northeast to north Brazil. And what it's really doing is helping our load factor overall, because we were being constrained on the other feeding routes on the shorter end (07:17), so we've opened up the pipes, and that's allowed us to have higher load factors, and that's why we were able to get an 81% load factor in the first quarter because not only did we fly high load factors on those A320 routes but allowed us to fly high load factor on all the flights that are feeding those routes as well.

It also is a big benefit for our ancillary revenue where we can carry more cargo on these bigger airplanes, we can sell more travel packages, TudoAzul – Azul Viagens, our package division was up 30% in business in the first quarter. And then also, we have more seats for our loyalty program because even though we fly a high load factor in terms of absolute seats, we have more seats for the loyalty program because of the larger aircraft size.

And so the A320s in our first quarter only represented 11% of our ASKs, and an ideal number for a route just in today would be something around 35% to 40%. And so we have a lot of margin expansion going forward, we feel, as we continue to add these

A320s and replacing the E-jets. So, the E-jets will either come off lease or they'll enter some markets that the ATRs - more mature markets where the ATRs are flying or at frequency that we need because of this increased load factor because of the feed from the A320s. So we're very excited about that. Our Chief Revenue Officer, Abhi, has been asking for these airplanes for a long time and they're really having a huge positive effect on the company.

Turning over to the next page, slide 9, our loyalty program continues to grow quickly. We've reached more than 7.2 million members representing an additional 1.2 million members over the last 12 months. We also increased the gross billings by 53% year-over-year and that primarily comes from selling banks that are buying points from us, so we're very pleased with that. And of course, unlike other competitors, you have loyalty programs in Brazil. Our TudoAzul is 100% owned by the company and is an important driver in our future margin expansion going forward.

Lastly, before I turn the time over to John, I just wanted to tell everyone thanks for a really successful IPO. We had a lot of investors that showed a lot of confidence in us. Obviously, it was over-subscribed and that allowed us to exercise the green shoe and do the fully - exercise the green shoe. And also, there was overallotment of 20% which was exercised. The total offering size was $644 million. $406 million of primary proceeds came into the company, which will boost our balance sheet and helping u reduce our working capital going forward. Stocks traded well since our IPO and we look forward to further innovation and value creation for our shareholders.

So with that, I'll turn the time over to our CFO, John Rodgerson, to kind of give you more details on the numbers.

John Peter Rodgerson {BIO 17734009 <GO>}

Thanks, David, and welcome, everybody, to the call. Going on to the slide, first quarter highlights as a privilege of sharing our financial numbers with you this morning, we had a very solid first quarter this year with an operating margin of 11%, 10.6 margin points higher than last year despite the year-over-year increase in fuel prices. In addition to having a revenue growth of 12% year-over-year, our continued efforts towards having a low-cost structure also contributed to our strong performance as we're able to grow our revenues 12% without increasing our costs.

Our CASK ex-fuel decreased 6.9% mostly due to the 20% appreciation of the real and the introduction of the A320neos, which had 30% lower unit costs than our existing aircraft. We also had a significant reduction in financial expenses of 35% year-over-year or BRL 76 million in the first quarter. This was driven by our aggressive approach to paying down more expensive debt and interest rates in Brazil coming down year-over-year.

Our EBITDAR for the first quarter totaled BRL 562 million, an increase of 36% year-over-year and our EBITDAR margin was 30%, one of the highest in the industry. We also recorded a net profit of BRL 55 million, an improvement of BRL 122 million over last year.

Going to the next slide and giving a quick look at our revenue figures, we had strong RASK performance in the first quarter with an improvement of 9.4% year-over-year, driven by 5.5% increase in PRASK and almost a 40% increase in other revenue per ASK. Our PRASK increase was driven by 3.3-point load factor increase and a yield improvement of 1.2% over last year, and our stage length essentially remained flat at 881 kilometers.

Looking at our ancillary revenue, our ancillary revenue, on slide 14, increased 28% year-over-year. It actually increased 43%, but if you exclude the sublease revenue that we had in the first quarter - sorry, we have window washers that are actually washing our windows during our first quarter earnings call, so if you hear a little bit of background noise, I apologize for that. We had higher passenger-related ancillary revenue such as the sale of our Espaço Azul, our even more legroom product that we have onboard, the aircraft upgrade and Skysofa, an increase of 7% in the number of passengers year-over-year. Other revenue represented 13% of our total revenue. Adjusted for the BRL 29 million revenue received from the aircraft subleases, other revenue per passenger totaled BRL 43.

Going forward, we expect ancillary revenue to remain flat at 13% to 15% of total revenue with growth coming from the higher passenger counts through the A320neos and the introduction of our baggage fees.

Going to the EBIT margin bridge slide on slide 15, you could see a detailed breakdown of the key drivers that impacted our margin expansion year-over-year. Most of the increase in our margins is driven by the increase in revenue. You could see that we increased our revenue by BRL 205 million year-over-year in the first quarter. The 20% appreciation of the Brazilian real drove down cost by approximately BRL 77 million, offsetting partly increase in fuel which is priced in U.S. dollars, reducing our aircraft rent as well as maintenance expenses which are primarily USD driven.

In the first quarter of 2016, we had aircraft redelivery expenses of BRL 39 million as a result of our fleet restructuring that took place in 2016. We obviously did not have those expenses in 2017. This improvement in costs was partially offset by an increase in fuel prices, up 16% in real from BRL 1.7 per liter to BRL 2 per liter. Salaries and other line items that are just per inflation increased by 33% year-over-year. The growth in salaries is mostly due to the annual increase in wages, negotiating with our union of 7.4% which is indexed for the annual inflation rate. All airlines in Brazil potentially give the same increase year-over-year.

Moving on to our balance sheet and liquidity position on the next slide, we ended the quarter with a solid cash position of BRL 1.5 billion. Including receivables, our total liquidity position was BRL 475 million higher than March of 2016, reaching BRL 2.1 billion. It is important to note that this does not include the proceeds from the IPO which cash entered into the company in April. We amortized BRL 401 million in loans during the first quarter of 2017 resulting in a debt position of BRL 3.7 billion and leverage ratio of 5.1 times. With the proceeds of the IPO received in April of approximately BRL 1.3 billion or $406 million, our cash position was significantly strengthened and will be going forward as we lower our borrowing cost by paying down more expensive debt. Our pro forma leverage in Q1 including the IPO proceeds would have been 4.4 times. That includes all of our debt.

Going on to the outlook on slide 2017 outlook, I want to highlight we are planning to increase our departures by 1% to 2% this year. ASKs will be up 11% to 13%. That's primarily driven by the upgauging that takes place as we take the A320neos. It's also important to note that the A320neos entered our fleet in December of 2016, so a lot of this growth is primarily removing aircraft on longer-haul routes that were being operated by E-190s and E-195s and replacing them with A320s. We expect our CASK ex-fuel to go down by 3.5% to 5.5% as we continue to manage our cost structure at Azul. And we expect to have an EBIT margin of 9% to 11% for the year.

With that, I think we'll turn it over to the operator to answer your questions.

Q&A

Operator

Excuse me, ladies and gentlemen, thank you. We will now begin the question-and-answer session. Our first question comes from Michael Linenberg with Deutsche Bank.

Q - Michael J. Linenberg {BIO 1504009 <GO>}

Yeah. Hey. Good morning, everybody. I guess I had a couple questions here. I want to - on your cost guidance, they're down 3.5% to 5.5% for the year. How much of that is the induction of the new A320neos versus the fact that I think there's been some cleanup and some restructuring going on in the carrier. So, like, for example, if I look at your operating fleet versus what you're contracted, I think you're still carrying, maybe, four or five excess airplanes. Can you talk about, like, what are the various levers of cost reduction in 2017?

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

Yeah. Mike, the majority of it is coming from the A320s. As you know, the unit cost of those is about 30% below the operating cost of a new jet or an ATR. So, that's the primary driver. We do have some non-operating aircraft that are exiting the fleet in - just in Q2 alone, we're transferring four E195s to TAP. And so, that's something that by the time we get into the third quarter, that'll be cleaned up quite a bit. There's not a significant amount of carrying cost that we have. And, in fact, last year in 2016, we had more carrying cost for the - as we did the fleet restructuring as we're getting ready for the A320s to come in.

Q - Michael J. Linenberg {BIO 1504009 <GO>}

Okay. Great. Then, John, just on the total ancillary revenue, I think you had indicated going forward the run rate is 13% to 15% of total revenue, but I presume that that's excluding the TAP sublease revenue. Is that right?

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

That's correct. We wanted to show you kind of the real number. And if you take a look at – Michael, if you take a look at what we did in terms of ancillary revenue in the fourth quarter versus the first quarter, it was basically in line. We grew ASKs from Q4 into Q1 by about 8% and that's about what the ancillary revenue increase. So the first quarter of 2017 is the first quarter that we didn't have a year-over-year comp to compare with because we started the sublease into TAP at the end of second quarter last year. So, once again, in the second quarter of this year, it will be a big year-over-year increase because of the sublease.

Q - Michael J. Linenberg {BIO 1504009 <GO>}

Okay. Then just so sublease was BRL 29 million in the March quarter, what is that number when you add the four E195s, what does that numbers go to? This is just for modeling.

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

Michael, it's going to go up slightly, but actually those four aircraft that we're sending to TAP, we're actually selling them. And so they're actually going to be exiting the fleet overall. And so it's a little bit different than the sublease. These aircraft are actually exiting – two of the four are actually exiting the fleet entirely.

Q - Michael J. Linenberg {BIO 1504009 <GO>}

Okay. Just a follow-up on that, the ones that are existing, is there going to be any sort of debt or lease reduction that comes with that?

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

Slightly. They were all owned aircraft, Michael. And so, basically, what we're selling them for is roughly what the debt and what the book value was. So I think there was like – in Q1, I think we recognized BRL 3 million or BRL 5 million worth of gain. It was insignificant.

Q - Michael J. Linenberg {BIO 1504009 <GO>}

Okay. Very good. Okay. Thank you.

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

Thank, Michael.

Operator

Our next question comes from Renato Salomone with Itaú BBA.

Q - Renato Salomone {BIO 17292431 <GO>}

Hi. Thanks for taking the question. Of the 5.8% yearly RASK growth, how much you attribute to industry wide capacity adjustments made in 2016 and how much to improved demand dynamics in domestic and international routes?

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

Hey, Renato, it's Abhi here. So, as with the quarter, I'll separate domestic and international. Domestically, I think that we had a pretty good January. Our year-over-year RASK improvement last year in the first quarter was not as high. And so, we had a – in terms of comps, first quarter will be our easiest quarter in terms of comps. I think we had a pretty good January in terms of year-over-year. We had Easter shift into April. So, that affected the year-over-year comps for March. But I would say that January and March in the quarter were probably the better months in terms of demand and domestic demand environment. Carnival was late, was February 28, so there was kind of a valley in the middle in between summer break and when Carnival corporate didn't really get started and Leisure was kind of waiting for Carnival. So, in terms of demand, I would say January was pretty good and then we saw a bump post Carnival holiday in March and that's domestic.

International, I can't give you sort of the actual breakdown, but you heard on the calls from United, American, and Delta, they've all spoken very, very positively about their Brazil unit RASMs and I think that you can assume that the rising tide is lifting all the boats in that market. I think you'll probably hear something similar from LatAm as well. So I think international, there's no question that the demand environment is strong. All of the airlines are seeing that and that definitely played an important role in this unit revenue increase, and domestically January and March were better and we definitely saw a little bit of a demand improvement post the Carnival holiday in March.

Q - Renato Salomone {BIO 17292431 <GO>}

Thanks, Abhi. And if I may have a quick follow-up here. Actually, there's strong international figures in the load factor you had in the first quarter. Can we expect international routes to remain above breakeven even during the low season months?

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

Yeah, the international booking curve is further out in the domestic one which is good because it gives us visibility. And what we are seeing in terms of those trends continue to be very positive. And right now, we can even look as far as in July, for example, which I think is going to be very good. I think it's going to be very good for all of the airlines that are flying international in and out of Brazil.

So, yes, I think we're optimistic about that market. And as far as we can see, it's going to be good. So, as we look at our demands for international, I think it's going to be at these levels. And I think the margins are – it's going to be strong.

Q - Renato Salomone {BIO 17292431 <GO>}

Thank you.

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

For those of you who don't know, Abhi is our Chief Revenue Officer. We didn't notice him. But obviously, it was evident by his response of that.

Operator

Our next question comes from Daniela Bretthauer with Eleven Financial.

Q - Daniela Bretthauer {BIO 13380169 <GO>}

Good morning, everyone. Congratulations on your first quarter results, quite solid. First question, I just want to follow up on Mike's question on the other revenues. Do you think that, John, the level going forward is going to be BRL 200 million and something, like BRL 250 million or in other words around – more towards the 15% of revenues?

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

Yeah. Dani, I think so. I forgot to highlight, we grew cargo 34%. (23:55) our cargo business is doing phenomenally well. Obviously, this did not include bag fees in anything that you saw in the first or even in the second quarter because our bag fee is set to be rolled out on June 1, but I think it's around that number.

I just would caution you a little bit, Dani, as you get into the second quarter. Second quarter is seasonally the weakest quarter for us and first quarter is a very strong demand environment. But I think in that 13% to 15% range is where we want to be excluding the TAP revenue and obviously with bag fees. And moving forward, we would expect that to go up a point or so because of that.

Q - Daniela Bretthauer {BIO 13380169 <GO>}

Okay. Thanks a lot. That's clear now. And you also mentioned – I just wanted to – if you could provide some color on your cash position, you mentioned that the BRL 1.5 billion does not include the BRL 1.3 billion from the IPO proceeds, and you did say BRL 401 million in terms of working capital that in first Q. What sort of cash position should we expect in the second quarter? I mean, do you plan or are you planning to pay anything else during the second quarter and what sort of running rate in terms of cash can we model for second Q and going forward?

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

You now, Dani, I think this is an internal debate between myself and David. David would prefer to pay down all of our working capital debt. Just as everybody's aware, we have roughly BRL 1.7 billion of working capital debt that's very expensive. It's with the Brazilian banks and our goal is to aggressively pay that down. And so we may swap that for some cheaper capital in the short term, but we're not giving a forecast on cash right now. But I would – it's going to be in the 15% to 20% range. And what I will tell you is every time we pay down this more expensive debt, it frees up a tremendous amount of receivables and gives us – it opens a lot of options to us. And so, what I will tell you is since we went public, our phone has not stopped ringing of people that are wanting to do deals with us to refinance our more expensive debt and so we're actively looking, Dani.

So we've got good debt on the balance sheet, which is our aircraft debt. And so we've already paid, just to give you an idea, another BRL 400 million with the IPO proceeds. And so, that's something that we're very, very excited about and you'll start – this is really a margin expansion story as we've proven in Q1 and a deleveraging story as we strengthened the balance sheet considerably. And we do get a lot of help from interest rates dropping in Brazil, but the IPO proceeds are very accretive to us going forward.

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

And, you know Dani, I think whether we keep the money in cash and we're earning interest on it, it's not like a U.S. airline is earning almost zero interest. Our interest rate that we make money on, what we pay for the working capital debt is like 1.25% or 1.5% (26:58) different than what we're actually making. So there's a very little difference between keeping the cash in the company really and paying it up. I love paying it all up, but it doesn't really affect the bottom line that much whether we keep it all in cash or we pay it off. But we certainly paid off the most expensive, and we'll continue to aggressively do that and keep a comfortable amount of cash in the company.

Q - Daniela Bretthauer {BIO 13380169 <GO>}

So, just to recap, you paid another BRL 400 million in that in the second Q and we can model cash position as a percentage of LTM revenue between 15% and 20% going forward.

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

Yeah. That's right. And we can give you more detail as we look at this going forward. But the IPO proceeds really hit the bank end of April by the time everything close and we're now looking at more efficient capital structures going forward as well. So you'll hear a lot more about that on our second quarter earnings call, Dani.

Q - Daniela Bretthauer {BIO 13380169 <GO>}

Thanks a lot. And congrats again.

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

Thank you.

Operator

Our next question comes from Stephen Trent with Citigroup.

Q - Stephen Trent {BIO 5581382 <GO>}

Hi. Good morning, everybody, and thank you for taking my questions. Some of mine were already answered, but just one or two others. When we look at your capacity growth for the year, your plans to grow capacity 11% to 13%, any view to what extent some of that should come from longer average stage length?

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

Yeah. Hey, Steve. This is Abhi. So...

Q - Stephen Trent {BIO 5581382 <GO>}

Hey, Abhi.

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

We can separate the 11% to 13% in domestic, international. So the 11% to 13% is overall, and you can expect that the domestic market is going to be in the range of 8% to 10%. So, what's going to happen with our domestic capacity actually is that more than 100% of our domestic capacity is going to be the A320s, so the combination of larger aircraft and longer stage length. We're actually reducing ASKs on our E-jets as some of them go to TAP, some of them come down into shorter-haul market and we're reducing ASKs on our ATRs. So, domestically, you can think of it – all of it as A320s combination of larger aircraft and longer stage length.

Q - Stephen Trent {BIO 5581382 <GO>}

Okay. Thank you, Abhi. Very helpful. And just one other question. I know, Abhi, with your international partnerships, you've got some very interesting ones out there. And I believe, for example, that you were looking to upgrade your interline agreement with Hainan Airlines maybe into the full pledged code share and I wasn't sure if that happened. So kind of curious kind of what's your strategy in the long-term relationship with Hainan and with TAP. I know you got that (29:56) on your balance sheet.

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

Yeah. I can talk about the code-share and then maybe David can talk about the strategic aspect. But yeah, so we do plan to have a code share with Hainan. As you may or may not know, Beijing Capital Airlines is going to start a flight from Beijing to Lisbon that will start in July. And so we intend to code-share with them on their Beijing-Lisbon flight and they will code-share on our Campinas-Lisbon flight. So we are in the process of a code-share with Hainan and hopefully we'll have that announced pretty soon.

In terms of our agreement, we're absolutely agreeing agreements to feed airlines here in Brazil. So using our domestic network, our two biggest partners, as you know, are United and TAP, and they're very important to us, but we're definitely open and we are talking to other airlines to feed them domestically here in Brazil. For our long-haul network, we use United and JetBlue in the U.S., both very important to us and we use TAP which is absolutely critical for us in Europe. So, that's the code-share stuff. David, why don't you talk about the strategic.

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

Yeah. I think Abhi mentioned Beijing Capital Airlines is – Hainan has several airlines in China. Beijing Capital Airlines is one of them that's based in Beijing that's very strong and very well positioned at the new Beijing Airport, so they're starting, I think, just three flights a week. I'm kind of encouraging them to increase that frequency and hopefully they'll get that up to daily service. So that's really important to us.

And we'd also mention that the strength that we're seeing in international traffic is also – TAP is seeing the same. They got a lot more presence coming to Brazil than we have going to Lisbon, maybe 10 or 11 or 12 times or 14 times more, but they're seeing that strength. It's about 35%, 40% of all their revenue is Brazil-related and so they're seeing the same strength. We're also seeing a lot of strength in the North America as well. So we're pleased with our investment at TAP, and with the partnership and all the things that we're doing together, it's really a win-win for us.

Q - Stephen Trent {BIO 5581382 <GO>}

Okay. That's very helpful, guys. And thanks very much for the time and happy to hear about the cleaning windows there (32:15).

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

It gives a good outlook, man. When the windows are clean, we can see clearly.

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

Well, actually, we stop on complaining sort of we are ending up with dirty windows because (32:27) cleaning becomes right, unfortunately.

Operator

Our next question comes from Dan McKenzie with Ben Hall (sic) [Buckingham] (32:40) Research.

Q - Dan J. McKenzie {BIO 15071178 <GO>}

Hey. Good morning. Thanks, guys. I just had a few questions here. Just going back to an earlier question, John, wondering if you'd be willing to share with us if you take a look at the non-aircraft debt – that BRL 1.7 billion of non-aircraft debt on the balance sheet, that average interest expense – or average interest rate, pardon me, you're paying today versus some of the quotes that you're seeing, is there any numbers that you could share with us just at least based on what you're seeing so far?

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

Yeah, Dan. We haven't in our earnings release, but we're paying almost 14% in reais on that, (33:16) in Brazil is about 12%, 12.5%. Now, that's coming down. And so, obviously we're being pitched by a lot of banks to do some unsecured debts or maybe securing up assets that we have not levered up in the past to get that down considerably. And so, again, paying down 14% debt is critical for us. And we're going to do that as quickly as we can and replace it with a lot lower cost of debt. So, the majority of that BRL 1.7 billion is in that range, so that's the average cost of debt there.

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

And the (33:48) for my side would be increasing earnings so that we can...

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

Not trade yet, but just pay off debt.

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

That certainly makes us a lot stronger, and that's a big focus as well.

Q - Dan J. McKenzie {BIO 15071178 <GO>}

Okay. Understood. And then, the quotes (34:02) that you're bidding for the revised interest rates will be obviously a lot lower than 14% (34:06).

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

Yeah. They're significantly lower than that, Dan. Obviously those are banks just pitching to us at this point. But as David said, over the next, call it, six months or so, we're just going to pay down more expensive debt, and we'll see if there's an opportunity to swap some with a lot cheaper debt. But those are things that we're actively working, but we don't have anything kind of concrete at this time to talk to you about. But as soon as we do, we'll be more than happy to share that with you.

Q - Dan J. McKenzie {BIO 15071178 <GO>}

Understood. And if I could go back to the full year growth rate, it did come in quite a bit higher than at least what I had been thinking about for this year. And what's interesting to me is the economic outlook for Brazil still seems pretty week. You guys are able to boost ticket prices on this higher growth. So, first of all, just a couple of questions tied to this, because the growth at this point, it seems like it's backfilling, but does it contemplate any expectations for an economic stimulus package widening (35:04) its way through the Brazilian Congress first of all? And then, second of all, how does your outlook factor in the space of leisure versus corporate travel on recovery?

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

Hey, Dan. So, first, let me just break out the growth a little bit into domestic versus international. So, overall, we're looking at 11% to 13% ASK growth. Domestic, as I've said just before, would be probably in the range of 8% to 10%. So, we do have some flexibility there in terms of utilization. We can be on the lower end or on the high end of that depends on demand. International is going to be up. It's going to be up – the balance of that is going to be up 25%-plus. It is a very small base. So, although the number looks high, it's coming of a very small base. But the markets are doing great. And so, we're really looking to consolidate our position and strengthen our position. We aren't adding any new sort of destinations. We're just connecting dots that we already have and increasing frequency on the International side.

So, as you look at the overall capacity growth, 11% to 13%, domestic is going to be 8% to 10% and international is going to be the balance of that. As we look at the 8% to 10% domestic, again, more than 100% of it is the A320s. It's a combination of the larger aircraft and the longest station. So, our departures, as we said, are really increasing very minimal 1% to 2%. And of course, you've seen the cost economics of the A320 and how really efficient they are on these 2.5-hour, 3-hour flights. And what we've seen so far, as we put in the first seven, eight aircraft is that they really helped us as we say internally here widened the pipes on our trunk routes. These were routes that are very desirable destinations in the northeast of Brazil, and our aircraft was just too small.

And so, as we widen these pipes, not only are we more competitive on those local markets, but we're seeing a nice benefit on all of our connecting markets are beyond and/or before markets, our ATR markets, smaller E-Jet markets are really benefiting from that as well. So, yes, you're right, it is 11% to 13% ASK growth, 8% to 10% domestic, but more than 100% of that is just A320s, larger aircraft, very, very efficient and longer stage length. We're actually reducing capacity because stage length is coming down on the E-Jets and the ATR.

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

Let me just say one thing, Abhi, just following on Dan's next question about has Brazil come back yet, and the answer to that question is no, it hasn't. But we would have gone through the crisis much better had we had the A320s during the crisis. We basically were constrained on our most popular routes which are more leisure. The crisis really consisted of business travelers traveling less. That was really where – and that was the highest yield in business traffic. Where we didn't have the high yield business traffic during the crisis and then we didn't have seats going to the Northeast of the leisure markets.

So, now, we have these A320s opening the pipes. Abhi and I were just reviewing last week the year-over-year margin improvements on these routes where the A320s are flying, and they're stunning. And it's really the right plane for the right market.

So, that's what makes us really encouraged going forward, even without a recovery in Brazil. Now, we're hopeful we're seeing big stimulus package or we've got some reforms that are just about passing, be it the retirement reform or the worker reforms. And we've already passed the cap on spending in Brazil. So, leading indicators are kind of taking up our cargo business up, which is a good sign. But we don't want anyone to think that Brazil is back to robust stake, because it is definitely not. We're just running our business to cope with this and doing much better, because of the A320s, because of lower debt, because of the proceeds from this IPO. That's what makes us very encouraged. And then if we get a strong recovery from Brazil, hallelujah, things are really going to be great, so.

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

And I also want to just highlight, this is the lowest risk growth you could possibly have. Departure is up 1% to 2%, ASK is up 11% to 13%. So we're basically just putting more efficient aircrafts on our longer haul routes. And so A320s are not opening new markets for us. They're just widening the pipes.

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

Widen the pipes and to make it just a lot better. The economics on that route are just so much better.

Q - Dan J. McKenzie {BIO 15071178 <GO>}

Well, that's a very comprehensive answer. Thank you. And John, I think that you sort of allude to this that if we do get economic stimulus, it would sort of imply that things could get a little better. Are there A320neos that you might be able to get your hands on or aircrafts that...

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

Any question...

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

Hey, Dan, let's not go there right now. I think it's a very good question. I mean, I think – we're committed to – like I said earlier, we probably used 20, 25 of these airplanes. It's going to take us a few years to get there. But to the extent that we could move some E-Jets – move some airplanes or sell them or do whatever, then we certainly have the option of expediting that by moving – not adding incrementals but moving our delivery positions forward. And we've been approached by companies that want us to move forward, and we have that option. If we can make the fleet work with replacing the E-Jets for the A320s for important longer-haul routes.

Q - Dan J. McKenzie {BIO 15071178 <GO>}

That will be it for me. Thanks, guys.

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

Thanks, Dan.

Operator

The next question comes from Victor Mizusaki with Bradesco BBI.

Q - Victor Mizusaki {BIO 4087162 <GO>}

Hi. I have two questions here. The first one is more a follow-up on your cash position. So, think about the second quarter, how much of your cash you'd be denominating in U.S. dollars? The second question with regards to your guidance, I don't know if you can disclose the facts under the assumptions. And then, number three, here, I mean, you mentioned that the A320 will represent something around 35% to 40% of your total air space. Is it for this year or next year?

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

Yeah. So, just taking these in reverse order. 35% is kind of the optimal mix that we're not going to get to that for the next – probably three years or so. So, it's going to be 20% at the end of this year. FX and oil, we basically use the forward curve and so we kind of take a look at what the forward curve for oil is and what the forward curve for FX is, and that's what we use in our projections to get to our EBIT margin of that 9% to 11%.

As for the IPO proceeds, we've raised BRL 406 million, we kept BRL 100 million of it offshore in the U.S., so we'll opportunistically bring that back into Brazil but that's kind of been our USD hedge. And that will be so over the next, call it, six to 12 months. And so, you'll see us use that to pay U.S. dollar-denominated expenses, but that's roughly the order of magnitude that we protected kind of given the IPO proceeds. Hope that helps, Victor.

Q - Victor Mizusaki {BIO 4087162 <GO>}

Perfect. Thank you.

Operator

Our next question comes from Bruno Amorim with Santander.

Q - Bruno Amorim {BIO 17243832 <GO>}

Hi. Good morning, all. So, I have a quick question. Actually, I just wanted to know how do you see capacity allocation in the Brazilian domestic market evolving in the second half of the year. We know that your guidance implies an acceleration in ASK growth, mainly driven by the ramp up of the A320s. But what are your competitors doing in terms of capacity allocation from what you can see? Thank you.

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

Yeah. Hey, Bruno. Yeah. So, talking about our capacity first. Since we're up only 2.7% in the first quarter and we're guiding to 11% to 13% for the year, yes you will see our year-over-year capacity growth number increased. For example, in the second quarter, we'll probably be in the high-teens and then we will be in the mid-teens for the third and the fourth quarters.

Second quarter is going to be the high water mark in terms of ASK growth because Azul as well as the other airlines have cut a lot of capacity last year second quarter due to the crisis and the demand environment. So, for Azul, we will be in the high teens for second quarter and then we'll probably in the low to mid-teens for the third and the fourth quarters, and that includes domestic and international combine for Azul.

For the competition, I'm not seeing anything substantially different in how they are positioning themselves. Numerically, the capacity growth in the market will be higher than last year or the capacity reduction will be less. So, for example, Gol (44:13) as already said, they'll be down zero to minus 2, and probably closer to zero, if I were to guess. LatAm last year was down 10%. They will be down 5% this year. It's hard to repeat 10% and 10% again, and Avianca is growing as well.

So, numerically, yes, there will be less capacity reduction this year, although they will get more capacity growth. But I think what's more important is how the airlines are positioning themselves. I do see good discipline in the market. I see airlines sort of working in the geographies and in the markets where they are strong and working in the market that's working for them.

I don't see incursions into – for example, we are not entering anybody else's hub. We're not trying to take over other markets that we are not strong in. So, overall, I do see good capacity discipline in the market. I do not expect that to change at least from what I have seen so far. I have no major indications that that's going to change. So, I think overall, that's an optimistic sign for the industry. I think we should be encouraged by that.

And I also think that the unit revenue numbers, us and the competition, the two data points that you've seen so far this year are both positive. They had a very high base in 1Q and they had a stage length increase and still RASK was flat. And I think that's a good sign for the market that we are able to produce those kinds of revenues. And I think as the recovery gained momentum as David said, it should bring good news. So, in terms of capacity, I'm seeing pretty good discipline across the board. And as far as I can see, I think it will remain that way.

Q - Bruno Amorim {BIO 17243832 <GO>}

Perfect. Thanks very much.

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

Thanks, Bruno.

Operator

The next question comes from Savi Syth with Raymond James.

Q - Matt Roberts {BIO 20272688 <GO>}

Hey. Good morning. This is Matt Roberts on for Savi Syth. Actually, (46:20) if I'm asking some of those are already asked, please just let me know. I apologize there. But first, in terms of the (46:29) on June 1, how long is that could you think that will take to role across the network? And what type of contribution are you assuming from that in your EBIT guidance?

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

Yeah. Hey, Matt. So, in terms of the time it takes, it really depends on – sorry, there is no technical limitations to how long it takes. We could do it overnight if we want it too, I think, in terms of technical limitations. I think we just want to take it a little bit slow because this has been a very hard fought victory for the airlines. And we want to make sure that we implement this new concept for the Brazilian customer in a slow, organized, and deliberate manner.

We're not going to be militant about this initially. We want the customer to be comfortable with the new fair-branded products and how they're experiencing that at the airports, and at check-in and things like that. So, I think it's going to be – the pacing item is going to be the customer receptiveness, how smoothly it comes across the airports and the check-in process and the boarding process and roller boards and carry-ons and things like that.

So, we certainly want to do it as quickly as possible, but we're very cognizant that we want this to be a very, very positive experience for the customer both in terms of having our lowest fares available and in terms of the experience when they actually fly. So, I would say that that's probably the biggest pacing item. And we'll have to see how it goes.

My personal opinion is that I think the customer will be okay with it, and I think we'll be able to roll it out quicker than the media anticipated.

Q - Matt Roberts {BIO 20272688 <GO>}

Okay, good. Well, thank you very much for the color there.

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

And in terms of revenue and the guidance, we have nothing in there, zero revenue from baggage fees in the guidance that we showed today.

Q - Matt Roberts {BIO 20272688 <GO>}

(48:23) your EBIT guidance in terms of fuel and (48:43) levels?

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

Yeah, Matt. Just – we've basically just taken a forward curve and we're about 20% hedged for the balance of the year, and fuel prices that are above the forward curve. But our EBIT margin guidance is basically looking at the forward curve for FX and for heating oil.

Q - Matt Roberts {BIO 20272688 <GO>}

Great. Thank you so much for the time.

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

Thank you.

Operator

This concludes today's question-and-answer session. I'd like to invite David to proceed with resolving statement. Please go ahead, sir.

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

Great. I just wanted to close by saying, first of all, thank you to everyone in this room here who made this, I think, a very good call, and thank all of you who are on the call who are interested in as well, and those of you that represent investors. Just know that we're going to work our very hardest to increase value here. That's really what we want. Our interests are aligned and we wanted to make really the best company ever.

So, thanks again. If you have any questions, Andrea is always available. She can get questions to John, and we just want to be upfront and share with you as much information as we can so you can see a very transparent picture of what's going on here at the company. I think that's our goal.

So, thank you very much, and we'll talk to you next quarter.

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

Take care.

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

Bye-bye.

Operator

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