

Y 2019 Earnings Call

Company Participants

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

Other Participants

- Bruno Amorim, Analyst
- Gavin McKeown, Analyst
- Josh Milberg, Analyst
- Michael Linenberg, Analyst
- Rogerio Araujo, Analyst
- Savanthi Syth, Analyst
- Stephen Trent, Analyst
- Victor Mizusaki, Analyst

Presentation

Operator

Hello, everyone, and welcome to Azul's Fourth Quarter 2019 Results Conference Call. My name is Greg 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, Head of Investor Relations. Please proceed.

Andrea Bottcher {BIO 20316630 <GO>}

Thank you, Greg, and welcome all to Azul's fourth 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.

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Before I turn the call over to David, I'd like to caution you regarding our forward-looking statements. Any matters discussed today that are not historical facts, particularly comments regarding the company's future plans, objectives, and expected performance, constitute forward-looking statements. These statements are based on a range of assumptions that the company believes are reasonable, but are subject to uncertainties and risks that are discussed in detail in our CVM and SEC filings. Also, during the course of the call, we will discuss non-IFRS performance measures, which should not be considered in isolation.

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

David Gary Neeleman {BIO 687871 <GO>}

Great. Thanks, Andrea. Hello, everybody. Thanks for joining us on our fourth quarter 2019 earnings call. As always, I'd like to start by thanking our crew members who work hard every day to provide our customers with the best travel experience in the industry. Thanks to their dedication, we delivered another outstanding year of results, ranking us one of the most profitable airlines in the world.

In light of the recent developments related to the coronavirus, I think it is important to take a step back and highlight our investment case. When tough times come, it is always better to be the most profitable airline in the world than unprofitable, and that's obvious. Since our IPO, we have consistently delivered on our promise, we grew capacity almost 60% from '16 to 2019, while doubling our EBITDA. As we look into the next few years, we'll continue to expand our margins.

Most importantly, especially during uncertain times like this, we have a solid balance sheet with a comfortable cash position. On top of that, we have the strongest and most defensible network in Brazil being the only carrier in more than 70% of the routes we fly, which has always served us well, especially during difficult times.

On slide four, you can see the strength of our network, which received eight new destinations in 2019. Our superior customer service is another highlight of the year. Among the several awards we received, the one we're most proud of is the TripAdvisor recognized Azul as one of the Top 10 Best Airlines in the World and the Best Airline in Latin America.

Moving to slide five. Important to note that we are no strangers to difficult times. We've been tested and have a highly qualified management team in place, which has faced quite a few challenges before. I am confident that once again we will emerge stronger as we had before. John will go over the measures we are taking to prepare for the impact of the coronavirus. Of course, we are monitoring the situation worldwide, and I can say so far that we have hardly -- we have had hardly any impact on our domestic demand. The difficulty with dealing with this virus is the uncertainty. Thankfully every day that passes, the medical community and the scientists are learning more about who the virus affects the most, how it spreads, and how long it will last.

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There are coronavirus cases in Brazil and we know it's coming. We hope -- we are hopeful that the impact on Brazil won't be as severe as we've seen in the worst of the countries, because of the following: Brazil is a warm climate with the vast experience in dealing with tropical diseases such as dengue and Zika; Brazilians are a lot more accustomed to dealing with crises and health challenges than people in the United States or Europe, there are -- they've withstood a lot. The health system is capable of handling these types of events. One interesting thing to note as it relates to the climate, the flu instances in Brazil are 30 times lower than the United States. So obviously the transmission is more in colder countries, that's also to the benefit of Brazil. And then lastly, Brazil is one of the youngest and healthiest populations in the world. So, age really matters as well.

In summary, the situation is expected to last for four months and we are preparing accordingly. We remain confident in our long-term targets and are prepared to act swiftly if the situation in Brazil deteriorates. And we continue to do our best to deliver outstanding results to our shareholders, while at the same time taking care of our crew members and our customers.

With that, I'll pass the word over to John.

John Peter Rodgerson {BIO 17734009 <GO>}

Thanks, David. I would also like to start out by thanking our crew members who once again delivered great results in 2019. I know that the focus now is to understand the potential impact of COVID-19, but it's reassuring to note that in 2019, we're the most profitable airline in Brazil. We have the right strategy and the team to come out stronger. We're going to be okay.

As you can see on slide six, we grew our top line revenue by 33% to over BRL11 billion, while expanding EBIT margin to 24.1% in the fourth quarter. EBITDA reached a record BRL1.2 billion, up 62% year-over-year. RASK on a stage-length adjusted basis increased 4.5%, while CASK decreased 6.6%. Excluding the impact of the end of the payroll tax relief program, CASK would have fallen almost 9%.

On slide seven, I wanted to highlight the impairment charge that was recognized in the fourth quarter. It was in line with the estimate that we announced earlier this year. As you know, the replacement of E1s by E2s is value accretive for Azul, given the far superior economics of the E2s. We're also glad to see that the vast majority of our minority shareholders approved the acceleration of our fleet transformation. In fact, 97% of the votes received were in favor.

Moving on to slide eight. As you know, our business units, Azul Cargo and TudoAzul play a key role in our future growth and margin expansion plan. Azul Cargo had another quarter of great results, presenting revenue growth of 53% compared to 4Q 2018, mostly driven by the increase in cargo volume and our expanding presence in the e-commerce segment. We ended the year with a 23% share of cargo volume transported in Brazil; the second highest in the country, underlying the importance of our unique network reach.

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TudoAzul, our wholly owned loyalty program had a 41% increase in gross billings in the fourth quarter, ending the year with 12 million members.

As David mentioned earlier, the impact in Brazil related to the virus might not be as severe as we're seeing in the Northern Hemisphere. Nevertheless, during uncertain times like this, it's difficult to predict what will happen. That is why it is critical to have a comfortable liquidity position to face potential shortcomings in demand that may occur. As you can see on slide nine, we have significant sources of liquidity and unencumbered assets. We currently have BRL1.6 billion in cash, of which none is restricted. We have BRL1.2 billion in accounts receivable composed of easy to advance credit card receivables with no holdbacks.

We have BRL1.7 billion in security deposits and maintenance reserves with our lessors. Our assets also include our TudoAzul program, which is a 100% owned by Azul. TudoAzul is unlevered. We also have the ability to do forward sales of points if needed to banks. In addition to our loyalty program, we have our investment in TAP, a strategic asset unique to Azul.

Our balance sheet is further strengthened by the fact that 100% of our working capital is in local currency, including the US dollar denominated unsecured bond, which is hedged in reais. We have no PDP payments on aircraft CapEx commitments due in 2020. We have no significant debt repayments in 2020 as well. In summary, we have a very healthy liquidity position and we have always believed in the importance of holding a sizable cash cushion to face situations just like this.

On slide 10, you can see that in addition to our strong liquidity position, our operating cash flow adjusted for our rent payments was BRL1.7 billion in 2019 and we generated free cash flow of BRL270 million. CapEx expenses consists mostly of spare parts and heavy maintenance checks. So we have the flexibility to reduce CapEx if needed in the short term.

Moving on to slide 11. While we're closely monitoring the potential impact of COVID-19 on our 2020 results, our top priority remains the health and safety of our crew members and our customers. As mentioned before, our domestic bookings have remained stable. 97% of our flights are domestic and we are the largest airline in Brazil in terms of domestic departures.

Based on the best information available, we're taking measures to reduce any potential impact. We're reducing international capacity by 20% to 30% to reflect a lower demand environment. We're pre-emptively reducing our domestic growth. We will continue to replace our E1s with E2s, while putting all incremental deliveries on hold. We also implemented a hiring freeze and have launched an unpaid leave of absence program that we can use if the situation worsens.

We're also negotiating new payment terms with all of our commercial partners. I think that's one great source that we have at Azul. We have great partners with our lessors, our

banks, and our business partners like Airbus and Embraer that have been with us since the beginning.

Given the uncertainty related to the impact of the spread of the virus and the initiatives that we have implemented so far, we decided to suspend our original guidance until we have more visibility. As mentioned earlier, we are no strangers to short-term challenges. We remain confident in our long-term targets. In the meantime, we will remain focused on protecting and building up our cash position, while taking care of our crew members and customers.

With that, David, Alex, Abhi and I will answer your questions. I'll turn the call 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 Savi Syth with Raymond James. You may proceed.

Q - Savanthi Syth {BIO 17476219 <GO>}

Good morning, everyone. If you live here in the US or Europe, I think the headlines are dominated by COVID-19 and creating fear of flying. I'm just kind of wondering if you can talk to us about -- I know, David, you mentioned that generally resilient. But I was wondering if you can talk about Brazilians' willingness to travel either domestically, internationally, have you seen an impact there?

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

Yeah, Savi, I'll kind of start off. The headlines are not as severe here in Brazil. It's the third or fourth article, kind of when you open up news sites over the last few weeks. We're still trying to get more reforms passed in Congress, and that's really been kind of the lead story here. So that's why we've seen the domestic demand holding up. But I'll turn it over to Abhi to kind of give you more detail and color on demand.

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

Yeah, so, there's obviously a lot, and I'll talk about demand and I'll talk about capacity at the same time, because I'm pretty sure that's going to be the next question. And so if I miss anything, feel free to ask again.

Yeah, so overall -- I'll start with international because international is the easier piece actually. So we have seen a clear reduction in international demand, certainly due to virus, as well the dollar, both related. So it's hard to differentiate one from the other. But there has been a clear reduction in international demand really since two weeks ago, right, since the dollar first started to climb. So we've already made some strong adjustments. In fact,

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we made them the first week itself. I think on day three like Wednesday, two weeks ago, we already had cut about 30% of our international long-haul flying.

So for example, we delayed -- we suspended Campinas to Porto and Portugal from September to March. We're now moving that forward based on the recent move of the dollar and the recent news. We already had cut down many frequencies to Lisbon. We went from double daily on many days to a single daily flight. We've gone from seven times a week to six times a week in Orlando. Fort Lauderdale, we had a day time flight, we've cut that. And so we really attacked international on all markets, Argentina as well. We've seen about 20% to 30% reduction in international demand, up to now. And we've got so far 30% of our international capacity up to now.

Of course since last night, the dollar has jumped again, and so we're evaluating again this morning. The team is looking at what we can do. We're looking at the New York start date for example. We're looking at short-term frequencies, short-term cuts within the next 10 days. And we will basically do what's needed to be done in terms of international. So we're obviously -- we have flights leaving from Campinas from Belo Horizonte and from Recife. We will focus the capacity in Campinas, it's our strongest hub and it's our strongest point of local demand as well. And we would cut everywhere else and use the seats in Campinas with the accommodating passengers and things like that. It's also important to note that so far we have not seen an increase in no-shows. We'll see how it goes today, but up till now, an increase in no-show rates or a significant increase in customers wanting to change or cancel. Most of the impact was on new bookings. So that's the international part.

We'll move to domestic. So, as David said, as John said, we really had not seen anywhere near the impact that we've seen -- that we've heard about in other countries. Our domestic bookings are relatively -- compared to year-over-year, if I compare February and March, we were well into the double-digit growth of domestic revenue, which was an encouraging sign as we exited Carnival and really got into March, which is the first business month of the year. But of course, as the dollar has come up, we've evaluated marginal capacity. And one thing I do want to make very, very clear both international and domestic, there are no brownie points for bravery. There is no reason to fly things that don't make sense. There is no reason to do any of that.

We'll match demand with -- we'll match capacity with demand. Right. I'm not looking for any pride or anything like that. So we've already trimmed April based on what we saw in the dollar last week. We're obviously looking at it again. April, May, June is probably where we'll focus initially and then we'll look at July onwards. We're looking at -- we're going to concentrate our network in our hubs. So we will flow all the traffic over our hubs, VCP Campinas, Belo Horizonte and Recife. Anything that over flies, we'll cancel it, we'll force it over the hubs. Anything that has any destination served by multiple hubs will only be served by one hub. Anything that's high frequency that we can reduce to consolidate, we'll do that as well.

So that's kind of where we are in terms of domestic. Our growth projections of course, they have come down and will continue to come down for the year. And while we were looking at 20% for the year, that's definitely come down and -- to around 15%, I would say

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and that keeps coming down as we make adjustments. So that's kind of where we are in general. And again, just -- I don't feel any bravery, any brownie points for flying more than what's needed. We will match capacity with demand. And we'll know today, tomorrow, kind of how demand and all the actions that companies take in Brazil, but we'll do what's needed.

Q - Savanthi Syth {BIO 17476219 <GO>}

That's super helpful. And then maybe just a quick question on -- is there a risk, especially what you're seeing kind of Europe or maybe the domestic, the aircraft that you're subleasing to TAP and planning to do for LOT and Breeze, isn't there kind of any risk around those aircrafts, either kind of being returned or not being taken?

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

No, as of right now, Savi, everything is on. I mean, we have contractual commitments with Breeze, LOT and TAP in Portugal. And so, obviously, it's a fluid situation, what's happening, but I think you're seeing a lot of support from the EU for the airlines in Europe. And so we're going to continue to have those aircrafts exit our fleet.

Q - Savanthi Syth {BIO 17476219 <GO>}

Great, thank you.

Operator

Our next question comes from Mike Linenberg, Deutsche Bank.

Q - Michael Linenberg {BIO 1504009 <GO>}

I have a question on one of the points that you made in the press release around the outlook about, John, you mentioned that you're going to continue the replacement of E1s to E2s, but then putting incremental deliveries on hold. So I'm not -- can you just square that statement? It seems like you're going to continue, but then you're going to stop. What did you mean by that?

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

We have roughly 28 aircrafts going off property today. So we do have some contractual commitments to replace some of those with E2s.

Q - Michael Linenberg {BIO 1504009 <GO>}

Okay.

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

You know, net growth in terms of deliveries this year. But the network -- we believe this is a temporary adjustment because of coronavirus, and so we really can't take that many aircraft out of our fleet and not replace -- backfill some of that with E2s, so we'll do that. But any incremental shells will not be coming.

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Q - Michael Linenberg {BIO 1504009 <GO>}

Okay, good. So then, how does that -- like, if we think about CapEx for 2020, what was it coming into the year and what does that new number look like as of today or is that still in flux?

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

So Mike, I'll give -- I'll let Alex kind of give the specifics, but just keep in mind, all of these E2s are operating leases coming in with lower cash commitments than our current E1s. So these are all on operating lease. So there is no financing risk and there is no significant capital outlay to take these aircraft into our network.

Q - Michael Linenberg {BIO 1504009 <GO>}

Okay, that's helpful.

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

No, that's essentially it, Mike. The CapEx that we have planned for the year, which was roughly the same amount that we had for 2019, was essentially like, John said, spare parts and maintenance events that today get capitalized. And that will definitely depend on how much flying we're actually going to do in the year. So there we can certainly manage that number.

Q - Michael Linenberg {BIO 1504009 <GO>}

Okay, great. And then, Alex, since you -- since I have you on, just when I think about -- where are you from a fuel hedge position? And as we think about certain coverage, how are those hedges structured? Are you able to fully participate in the lower fuel price or is it by way of swaps, or costless collars? And therefore are we going to see a situation where maybe you have to post cash collateral or assets just to address that? Can you -- any color on that would be great.

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

Yeah so, as oil has been coming down, we had increasing -- we had been increasing our hedge position. So that was before the Saudi Arabia announcement. So our average for the year is above where it is today, but we have no outstanding margin calls right now. So obviously, it's very fluid, it's very volatile, but like we have been saying, we have great partners, we have great banks among our partners and we believe that if it comes to that, it will be something that we'll be able to talk about and it will be part of the cash management that we're focused on right now.

Q - Michael Linenberg {BIO 1504009 <GO>}

Do those -- when you think about like you talked about margin cost, do they typically settle end of month or end of quarter? Or maybe it's a variety of settlement dates?

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

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It varies. I mean, it can be daily, it can be monthly. It depends on the agreement. So that varies.

Q - Michael Linenberg {BIO 1504009 <GO>}

Okay. And then just I -- look, I know you guys just did 24% operating margin. So it's almost crazy that I'm asking this question. But I know, John, you did talk about the receivables and you said no holdbacks. Presumably though, you do have holdback provisions with your credit card processors. And I don't know if you can tell us maybe potential triggers, it maybe like a liquidity threshold, which as you went through, you have a significant amount of liquidity. So I suspect that you're well above those thresholds that would trigger a holdback. Again, any color, because things are moving so quickly and we just want to make sure we have all our ducks in a row. Thank you.

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

No, that's great, I'd say. And that's a very relevant question, Mike, because I think, for everybody on the line, that the way credit card receivables work in Brazil are very unique and they are significantly different from what maybe you see in the US. So I think it's worth spending a couple of minutes on that. So normally, there are no holdbacks, no covenants. There is nothing. We can -- and the fact that the Brazilian economy has been structured on selling any kind of goods, including tickets in installments, have all been set up to offer these payments in installments, but also to be able to advance those receivables very easily. Right. And so that is something that we've always been able to do.

And on addition to that, there is also whole other liquidity source, which we've also been using in the past, which is you can lever those receivables instead of advancing them and getting [ph] \$0.99 on the \$1. You can actually borrow against them, and [ph] potentially \$3 on the \$1, right. And so that's a significant source of liquidity. So if we were able to obviously maintain all of our credit limits and the risk appetite, which obviously is not the standard assumption that we have right now, but we could almost have BRL3.5 billion or more in credit lines that we could access, right. Obviously, we'll need to negotiate those, but those are seen as very solid and very secure receivables that we're normally able to borrow against.

Q - Michael Linenberg {BIO 1504009 <GO>}

And you, Alex, you said BRL3 billion to BRL5 billion more, right, did I hear that right?

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

BRL3.5 billion. It's normally a 3 to 1 actually [ph] you get. So \$3 for every \$1 in the receivable balance that you have. So roughly with our receivable balance, you'd be at about BRL3.5 billion as much of that amount.

Q - Michael Linenberg {BIO 1504009 <GO>}

That's great. I'm glad you highlighted that. Thanks. And, yeah, -- no, good luck. You guys had a nice quarter. Thank you.

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

Thanks, Mike.

Operator

Our next question comes from Rogerio Araujo, UBS.

Q - Rogerio Araujo {BIO 17308156 <GO>}

Yeah, hi guys, thanks a lot for the opportunity. A couple of questions here. One is on TAP's convertible bond. It is now recognized at BRL1.4 billion, and also included in Azul liquidity position. So in a moment, that investors start to test some scenarios. Could you provide some color on how liquid this is? Also there is some local news stating that Azul's controller was negotiating the sale of its office stake at TAP. So could Azul, still in this scenario, take the opportunity and make this investment liquid? So this is the first question. Thank you.

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

Rogerio, thanks for the question. First of all, obviously, we're in different times than we were at the end of the fourth quarter, and so -- when we marked that position. But it's a strategic asset. TAP is a strategic partner of ours. We own 47% of that company. And it's very important to the economy in Portugal and TAP is going to be okay. There were a news flow, and I'll let David comment on it as well, that we're negotiating a sale of TAP. Obviously that's on hold with the current situation. But I think it shows that that asset is liquid at varying levels, but we need to get through this crisis before we kind of talk about that. But our TAP on today is totally unencumbered and there's a lot of people that would have interest in that asset. And so that's why we included in our cash position. And in addition to the TAP bond that we have, we've got an enormous amount of cash, we have enormous amount of receivables, we have enormous amount of value into Azul. And so we haven't levered ourselves up recently using our receivable like Alex said. And so I think we're very comfortable with our position in TAP today.

Q - Rogerio Araujo {BIO 17308156 <GO>}

Okay. Very clear. And go ahead, sir.

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

Yeah, I'll just comment on TAP. Obviously, the European carriers are going through a challenge right now and the really good news for TAP is that the Portuguese government is our partner there. They are obviously -- the amount of return they get on TAP as far as -- I mean, just in payroll taxes and income taxes off the people that work there is probably \$0.5 billion a year. So, it's enormous and then the billions of economic impact. So it's great to have a partner that has a huge vested interest in the airline when times get tough. So we have a great relationship with the government and we're working really closely to kind of weather the storm here.

Q - Rogerio Araujo {BIO 17308156 <GO>}

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Okay, very clear. Thank you. So my second question is on the impairment that were already announced. There is some -- some impairment in fixed assets, I mean right-of-use. And so we noted there is some right-of-use for maintenance. So related to maintenance checks and multi-year maintenance and engine maintenance as well of BRL330 million. Could you please provide some color on this maintenance impairment, what it is -- how this is related to the EIs? And just for us to have some better view on also how to do this within the balance sheet? Thank you.

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

So I think it's all very consistent, it's all related to the acceleration of the fleet transformation and the removal of the EIs and replacing them with E2s. Some of it was on our balance sheet already and we're going to incur some costs to remove these assets just in terms of preparing them to be utilized by another airline. So everything is related to the EI, everything is related to the fleet transformation, and some of it, the majority -- vast majority of it was on the balance sheet, but some of it is the provision related to the actual removal of the aircraft.

Q - Rogerio Araujo {BIO 17308156 <GO>}

Perfect. Thanks so much. And good luck in this scenario and wish you all the best. Thank you.

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

Thanks.

Operator

Our next question comes from Stephen Trent from Citi. You may proceed.

Q - Stephen Trent {BIO 5581382 <GO>}

Hey, hello everybody, and thanks very much for taking my questions. And I would echo Rogerio's best wishes as well. Just one or two from me. If you could refresh my memory regarding international flights out of Brazil, is it the case that there is a 180-day regularity rate after which there'd be some risk that the slots get taken over. If you could kind of just give me some color how that works and what the regulator might be telling you guys as you're trimming some international?

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

Hey Steve, Abhi here. The only place where we are sort of slot constrained really is a Lisbon airport. And we expect for this period that the slot rules will be waived.

A - Andrea Bottcher {BIO 20316630 <GO>}

No, they've been already.

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

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They've already been waived. And so we're not expecting any impact in terms of these cancellations in terms of slots.

Q - Stephen Trent {BIO 5581382 <GO>}

Okay. I was imagining that they would waive. So that's great to hear. Appreciate that. And I actually missed part of the call and apologies, the early part. Did you -- I think you mentioned that maybe there'd be some delay in some of the planes that -- your delivery of aircraft, and if that is an accurate, it's also fair to say there's no penalty at all from the OEM that you guys needed defer for some period of time. Just wanted to make sure my understanding is correct.

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

Yeah, that's right, Steve. As I said, we have great partners in Embraer and Airbus, and we waited a long time for them to get their aircraft on time. They could wait for us. So, no incremental deliveries at this time. So let's get through this crisis and then we can talk about that at a future date.

Q - Stephen Trent {BIO 5581382 <GO>}

Well put, John. Let me leave it there and thanks for the time guys.

Operator

Our next question comes from Gavin McKeown, Amundi.

Q - Gavin McKeown {BIO 16048042 <GO>}

Yeah, hi guys, thanks for the call. Can I just ask a follow-up on some of the comments about dealing with partners, particularly lessor partners? Firstly, could you just remind me whether or not you've ever provided guidance on what the annual interest and lease repayments would be for FY '20 just given the pretty rapid change and the fleet mix towards the back end of last year, particularly -- and I think it was John's comments regarding negotiating with partners. I think you also mentioned lessor partners, which is probably early in your conversations with them. But I was wondering if there's anything you can point to in terms of what we could potentially expect or perhaps even remind us about things that you've done in the past or other airlines have done in the past in terms of trying to renegotiate lease repayment with the lessors? Thanks.

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

Yeah, let me just start. I mean, last year, we had BRL1.9 billion in lease payments, right. And so that's -- we show that to you on one of our slides. And we have BRL1.7 billion in maintenance reserves and deposits, right. So you kind of get an idea of how much security our current lessors have, and so it's a small industry. We've got great business partners that we've worked with through the last decade. And so, I think we're all in this together. I think the lessors know that these are uncertain times. And we've done things the right way for the better part of 12 years, right. And so, we've raised a significant amount of capital for Azul. We raised \$1.3 billion of capital to build Azul. We've got great

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business partners. We bought the local aircraft. We really trust in the lessors that we have as part of our book.

And so, the OEMs on the engine side, all of -- it's a big family in this industry and so we're going through a turbulent time, but it's in everybody's best interest that Azul comes out stronger on the back end. That's just -- I'm very confident now. It's in the lessors' best interest, it's in the bank's best interest and it's certainly in the Brazilian government's best interest, and we've got a lot of conversations with them over the last 48 hours as things are changing. And so, what -- when you take an aircraft from a lessor, you're making a long-term commitment with that lessor, 10 years to 12 years that you're together. And so what the lessors want is lessors want Azul to be strong and we showed them that we are one of the most profitable airlines in the world. We're going to continue to be on the backside of this.

And a lot of questions about, oh, what happens if demand drops off, let's not forget that, last year, our breakeven load factor was 63%. Fuel is half of what it was right now. Of course, we have the dollar challenge right now. We obviously have the coronavirus challenge, but these are bumps along the road. We told our investors all along that the long-term vision of Azul is to be -- continue to expand margins and to be a lot stronger and so we're going to have to go through these moments of uncertainty, that's part of our business. And most businesses are seeing that right now, not just the aviation industry. And so, when we talk to the local government and talk about what our plans are, what we're doing, we're very much aligned to kind of get through the latest storm that is the coronavirus.

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

And Gavin, just to add, this isn't theoretical, right. We've been -- over the last 12 years, we've been through situations where we needed to renegotiate terms and payment schedules and things like that especially before we went public. And so we know from experience and from having weathered these scenarios together with our partners that a) they are very willing to help, they're very supportive and it's mainly driven by need, right. So it's hard for us to be able to tell you what they would be able to accept, because it will very much depend on the situation, right. There'll be no overreaching, but we also will need to work to the extent that the environment that we're working in forces us too, right. And they've all been more than well compensated with business from Azul, right. We're a growing profitable airline that in normal conditions, is a very coveted business partner as well. And so that's what we -- that's sort of the asset that we lever against in times like these, and we've done it before and are confident that we can do it now.

Q - Gavin McKeown {BIO 16048042 <GO>}

Okay. And just on the first part of my question, can you just remind me on the -- sorry, lease repayments BRL4.9 billion last year, as you say, have you given guidance to what we would expect that to be based on the current fleet mix today for 2020?

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

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No, we don't give guidance on the lease, but it's completely dependent on the fleet, right. And as of right now, the fleet is very much influx and it will be adjusted as necessary.

Q - Gavin McKeown {BIO 16048042 <GO>}

Right, thank you.

Operator

Our next question comes from Victor Mizusaki, Bradesco BBI.

Q - Victor Mizusaki {BIO 4087162 <GO>}

Hi, I have two questions to you. The first one is a follow-up on the oil head position. I'd like to understand, is it possible or not to roll over these contracts in order to reduce the potential cash disbursements for 2020? And the second one, if you think about the fleet transformation plan and you have a slide showing the EBITDA increase, can you confirm the assumption forward price and how the current scenario can affect these potential EBITDA growth?

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

Yeah. So, on the hedges, yes, that's absolutely possible and we already have agreements to do it. Obviously, it's very hard for you to just figure out what the price is, right. So, we are going to -- maybe need to wait for a couple of days just to see what sort of price we can do that forward role at, right. But that's absolutely possible and it's something that we've already discussed and got an agreement on. And then you're saying of sort of the EBITDA, our estimate for the fleet transformation, is that the question?

Q - Victor Mizusaki {BIO 4087162 <GO>}

Yes, I mean, just to understand how the current oil price kind of affect these -- I mean, the decision to accelerate the replacement of E1s by E2s.

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

So, theoretically speaking, you've seen a bigger movement in fuel prices in oil than you've seen in -- even on the heating oil, so even on what we will probably see on jet fuel, right. Crude is more volatile than the refined products. And also, you've had the dollar movement that was in the other direction, right. So, fuel burn and fuel expense as of right now has probably come down on a net basis for a Brazilian airline, but the net result isn't what you would see, for example, in a US carrier, right. So, for us, the E2 is still a very valuable asset and it still is much better to fly the E2 than to fly the E1.

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

And Victor, a lot of it comes from -- we get incremental revenue per shell. We're actually flying those aircraft kind of in January as much as 12 hours a day. They produce incremental revenue and the cash outlay for rent is actually less than we're paying for E1s. So, it's certainly a no-brainer in any fuel scenario to be taking the E2s.

Q - Victor Mizusaki {BIO 4087162 <GO>}

Okay, thank you.

Operator

Our next question comes from Josh Milberg with Morgan Stanley. You may proceed.

Q - Josh Milberg {BIO 19336060 <GO>}

Hey, everyone. Thank you guys for the call. I had a question just related to your accelerated fleet transformation and the impairment. Rogerio touched on this. But this quarter, we saw how much of the impairment resulted from DNA proving greater than what was provisioned. And John on the last call, I think you had talked about that reflecting the sins of the past and I was just hoping you or Alex could elaborate a little on that point and just indicate why we can feel comfortable, we won't see larger aircraft related impairments in the future.

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

Yeah. No, absolutely. I think when John talks about this, what he is saying is that E1 is -- we're very grateful to the E1 because it brought us here, but it is an aircraft that has very expensive rent, right. And why is the rent expensive? Because of when we took delivery of the aircraft, right. The aircraft, we committed to getting these aircraft when the aviation market was essentially a seller's market, there wasn't a lot of E1 slots available. We were a young airline that was just starting up and so our credit was nowhere near as strong as it is today. And the cost of capital at that time was also very high, right. And so, when we made the commitments to the E2, everything was at the other end of the extreme, right. We had a -- we took advantage of a very good market in terms of the price of the asset. Our credit is at a record high level and the cost of capital came down significantly over the years.

And so, when you look at it, we are paying per month on an E1, a little more than we pay per month on an E2, which has lower fuel burn and more seats, right.

To your question of whether there will be impairment in the future, I mean, that's obviously very hard to gauge, but there is not -- it's very unlikely, right, because we're at the beginning of the life cycle of the E2. It's a next-generation aircraft. We're at the front end of taking deliveries of these aircraft. We're going to get to 100% of our capacity coming from next-generation, probably seven or eight years ahead of our competition, right. So, by the time they are trying to get their next-gen aircraft, we'll already be flying this aircraft eight years. We'll be essentially two-thirds done with the leases on the first aircraft, right. So, we're at the front-end of this curve. So, it's a very, very different scenario from when we took the E1s. So, it's really apples and oranges.

Q - Josh Milberg {BIO 19336060 <GO>}

Okay, got it. That was a very comprehensive response. Really appreciate it.

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

Thanks, Josh.

Operator

(Operator Instructions) Our next question comes from Bruno Amorim, Goldman Sachs.

Q - Bruno Amorim {BIO 17243832 <GO>}

Hi, good morning, everyone. So, my question is related to your capacity in the Brazilian domestic market. How should we think about the flexibility that you have and how much capacity could you realistically take out of the market if this additional move is necessary? Back in 2015, you had some airlines abroad, which were able to absorb airplanes, which were no longer helpful in Brazil from several airlines. But it seems that we are living in a different environment. So, how should we think about the flexibility that you have in case you need you to cut capacity in the Brazilian domestic market? Thank you.

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

Yeah, hey, Bruno. Yeah, so as I said, I have no intention of flying empty airplanes, and definitely not flying when demand is low. So, we will definitely match capacity to demand. We have a lot of flexibility this year because we have in our program this year, as John said, 28 to 29 EIs coming out of our fleet. And so, we can choose how many of them we want to replace, right, based on what the demand scenario is. Right now, our base case is that we want to replace as many of them as possible, because we think the E2 is a much better airplane for us, short term and long term. But if we do see the demand environment deteriorating further and deteriorating drastically, which we have not seen so far, but in the case that that does happen, we definitely have the choice of how many of those EIs we want to replace. And so we actually have naturally a lot of flexibility this year in terms of how much of the capacity of the exiting airplanes we want to replace or not.

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

Yeah, and if I could just add to what Abhi said, I mean, keep in mind, we're flying our A320neos 15 to 16 hours a day, one of the highest in the world. We're flying our E2s 12 to 13 hours a day, one of the highest in the world. And so, there is a significant amount of capacity that can be ratcheted down if need be and I think that that's something that we want to continue to highlight.

Q - Bruno Amorim {BIO 17243832 <GO>}

Thank you very much.

Operator

Ladies and gentlemen, 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>}

I'd like to thank everybody for being on the call today and listening to our story. You will not have a more dedicated management team than you have here. I bought shares this morning personally. I know my colleagues have as well. We've been in a blackout and so we believe in the long-term strategy of Azul. We're going to get through this and close your eyes in six months and you're going to say, wow, this was an unbelievable time to buy Azul stock because Azul's going places. Thanks a lot everybody.

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Operator

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

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