

Conference Call

Azul

4Q18 Earnings Results

March 14, 2019

Operator: Hello everyone and welcome to Azul's 4Q18 results conference call. My name is Paula 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. Should any participant need assistance during this call, please press *0 to reach the operator.

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

Ms. Andrea Bottcher: Thank you Paula and welcome all to Azul 4Q earnings call. The results that we announce this morning, the audio of this call and the slides that we will reference are available on our IR website.

Presenting today will be David Neeleman, Azul's founder and Chairman and John Rodgerson, CEO; Alex Malfitani, our CFO and Abhi Shah, our Chief Revenue Officer are also here for the Q&A session.

Before turning the call over to David I would like to caution you regarding our forward-looking statements. Any matters discussed today that are not historical facts and particularly comments regarding the company's future plans, objectives and expected performance constitute forward-looking statements.

These statements are based on a range of assumptions that the company believes are reasonable; but are subject to uncertainties and risks that are discussed in detail in our CVM and SEC filings.

Also during the course of the call we will discuss non-IFRS performance measures, which should not be considered in isolation and are described in detail in our earnings release. With that I will turn the call over to David. David.

Mr. David Neeleman: Thanks Andrea. Thanks for joining us. December 2018 market our 10th anniversary. We can go right to slide three on the presentation it is truly amazing when you look at those two route networks what we have been able to accomplish in the last 10 years. When we founded Azul back in 2008 we had a clear mission to walk our crewmembers to the best jobs of their lives because we

knew our customers would that have the best flight experience of their lives if we took care about people. After 10 years we can clearly see the passion of our crewmembers. They love their jobs and our customers love the flying us. We could not have better ambassadors for our brand.

Because of this fantastic team we were able to build an unbelievable that work serving more than 100 cities with a fleet of 125 aircraft. We are building a solid foundation going forward. Every next-generation aircraft we add strengthened our network even more while reducing our costs. We are now starting to reap the benefits of our network we built, that we have built. In order to use the benefit of having great culture and brand when difficulties come like spikes in fuel prices and weakening currency we have the ability to recapture revenue to offset a significant portion of these costs - and that is exactly what happened in 2018.

Even though fuel was up 30% and the USD appreciated against the BRL 17%, we delivered record adjusted net income of 704 million in 2018. We also generated 266 million in free cash flow and ended the year with a total liquidity position of 4 billion BRL, reflecting our commitment to sustainable growth and building long-term value in the company.

You can see some of our amazing crewmembers on slide four. Because of them we can steer the rank as the most on-time airline in Brazil in 2018, and we were also recognized as the most on-time LTC in the world. That is a fantastic achievement considering the size of our network and the diversity of our fleet.

The performance of the new anacondas in our network has surpassed all our expectations. These aircraft are flying an average 14 hours/day improving connectivity across the airline just as we said it would. In the end of the year we had 20 new anacondas representing 30% of our ASK, which have a 29% lower unit cost than our current E1s. Every single one of these next-generation aircraft are desperately needed and will continue to be so for many years to come.

During the second half of the year we also started receiving the Embraer E2. We have talked a lot about that in past calls and I am very excited about it. Now that aircraft has a CASK that is 26% lower than our current E1s and has an impressive trip cost advantage of 20% to even our new our Neos that we are flying today.

With both these next-generation aircraft we are creating a competitive, sustainable advantage that will continue to drive margins higher. In summary, we ended up our first decade confident that we will continue to offer the best job in the lives of our crewmembers, which translates to the best flight experience for our customers, which we believe will continue to drive positive returns for our shareholders. With that I will pass the word over to John will give you more details on our 4Q results.

Mr. John Rodgerson: thanks David. As David looked back on what we built over the last 10 years I want to say we are just getting started and the task is still ahead of us. I also want to thank our crewmembers for all their hard work during the past quarter.

As you look into slide five the core airline drove stronger results in a tough microeconomic environment even with a 37% spike in fuel and a 17% depreciation of the BRL we reached and Ebit margin of 11.4% for the quarter and a 31% Ebitdar margin, while recording a net income of 138 million. The reduction in net income YoY was driven by a one-time gain we had in 4Q 17 related to the TAP fund that expired totaling 154 million.

We grew capacity by 14% in 4Q while also expanding our top line by 14%. Our RASK adjusted for stage-length increased 2.7%. It is even more impressive that our stage length adjusted RASK for the whole year increased 7.6% with a 16% increase in capacity.

CASK ex-fuel decrease 8.1% as we continued to add more fuel-efficient aircraft to our fleet. We ended the year with 28 new anacondas representing 30% of our 4Q capacity and expect to end 2019 with an industry-leading 50% of our capacity coming from next-generation aircraft.

As you can see on slide six fuel and currency had a negative impact of approximately 270 million BRL in our 4Q operating results, which represents 12 p.p. Thanks to our margin expansion strategy our ability to recapture revenue and reduce costs we recorded operating margin of 11.4%, recovering 10 of the 12 p.p. during a very challenging macro environment.

Moving on to slide seven our loyalty program TudoAzul maintained its strong growth phase during the quarter reaching 11 million members. Gross billing ex-Azul went up 29% YoY. We now have gross billing share of 18% up from 16% just one year ago, and still well below our fair share of this market. We will continue to focus and growth of this business.

On the right side of the slide you can see that our cargo business continues to perform extremely well. Revenue increased 57% YoY benefiting from the expansion of our network and fleet with a diversified customer base including the main retailers, manufacturers and online companies in Brazil, who value our reliable and far-reaching logistics solutions.

Looking at the balance sheet on slide eight I am proud to report that we ended the quarter with a strong liquidity position representing 44% of our last 12 months revenue, while also reducing our total debt to 3.4 billion BRL.

On slide nine we give you look at the impact of IFRS 16 on our 2018 results. The new standard becomes effective January 2019 and consists of recognizing all aircraft on balance sheet, similar to how finance leases were treated before. In addition, under this new rule some maintenance expenses for leased aircraft will also be capitalized and as a result our Ebit margin in 2018 would have been 15.1%, 6 p.p. higher than the 8.8 bps reported under IAS 17. Under the IFRS 16 our Ebit margin is the best in the region. Our leverage would have been 3, a reduction of 1.2.

Going to slide 10 and looking at our 2019 guidance we expect to grow our total ASK between 18 and 20% in 2019, with most of this growth coming in the domestic market. As we have been telling you our domestic capacity growth will be low risk and focused on strengthening our network driven by replacing smaller aircraft with larger aircraft in routes we already serve.

As a result of the acceleration of our fleet transformation plan that we announced earlier this year we will end the year with approximately 50% of our ASK coming from next-generation aircraft. On the cost side we expect CASK to go down 1 to 3% in 2019.

As you know we have a multi-year margin expansion strategy and we expect to grow our Ebit margin every year over the next few years. Consistent with this strategy our Ebit guidance for 2019 will be 18 to 20% compared to a margin of 15.1% in 2018. This estimate is not taking into consideration any impact related to aircraft sales transactions or the potential acquisition of selected assets from Avianca Brasil.

Moving on to the last slide we have been monitoring Avianca Brasil's judicial recovery process very closely and have identified an opportunity to further strengthen our network and accelerate our fleet transformation plans. Earlier this week we announced that was signed a nonbinding agreement with Avianca Brasil to acquire certain assets four 105 million USD. These assets consist of Avianca Brasil's operating certificates, 70 slot pairs and approximately 30 Airbus A320.

It is important to highlight that these assets will be transferred to a new entity, a new Co. which will be framed clear of all debt and liabilities as provided by the Brazilian bankruptcy law. Also the operating lease contracts of the aircraft that will fly at the new company will be all renegotiated to market rates. The offer is subject to a number of conditions including the due diligence process, regulatory credit approvals, final approval from the bankruptcy judge. We believe this process could take approximately 3 months. In summary we are confident of the future of the Brazilian aviation market and our ability to continue expanding margins creating the

best experience for our crewmembers and customers. With that David, Alex and myself and Abhi are here to answer questions.

Q&A Session

Operator: ladies and gentlemen thank you. We will now begin the question-and-answer session. If you have a question please press the star key followed by the one key on your touchtone phone now. If at any time you would like to remove yourself from the questioning queue press star two. For those following the call via webcast you may post your questions on the platform and they will be either answered during this call or by the Azul investor relations team after the conference is finished.

Our first question comes from Savi Syth, Raymond James.

Mr. XXX: good afternoon this is Matt for Savi actually. My first one John in regard to Avianca Brasil if it is successful could you talk a little bit about how long you think the transition period will last, what the nonrecurring migration cost might be and in terms of how much inventory is already sold, how much... that would be great.

Mr. Rodgerson: yes Matt. So I think the process should run pretty quickly as there is a creditors meeting later this month and bankruptcy judge is aware of the situation. I think we cannot really get behind the scenes of what is happening today; but we believe there is a tremendous amount of upside in how this network could plug into our network. So as we look forward with think we could do it relatively quickly. They are coming with an operating certificate, with pilots that are already flying, they are already certified on the aircraft. So at this time we really are not giving any estimate.

We do not believe it is a significant acquisition or a big integration, because when it comes into a new Co. a lot of the typical headaches you get with a normal acquisition you do not have to experience. So again we are excited about it. I think either way there is going to be less capacity in the market because of this, is what we are looking at acquiring an airline that has got roughly 30 aircraft in their fleet and they had up to 55 aircraft just last year. So I think overall this is very positive for their customers, for the crewmembers and certainly for Azul. I think overall for the industry as well, because there is going to be some capacity rationalization that happened as a result of this.

Mr. Matt XXX: thanks there and then also in terms of capacity in the US to Brazil market things like schedules are showing certain amount of cuts going into 2Q and that is before any of all the... So do you think cuts excluding what is going on is sufficient in the current flight demand?

Mr. Abhi Shah: Matt, Abhi here. Yes you are right. We are seeing capacity cuts mostly May onwards. Pretty much everybody is participating, including Azul. So I think as has been the sentiment of other colleagues in the region we have some pretty tough comps first two quarters; but 3Q and 4Q we expect to see an improvement in the international market driven by stability in the currency as well as these capacity cuts.

So the booking curves are longer, so we are going to see when we get there; but I am definitely very encouraged by the capacity cuts. I am seeing right now US Brazil nonstop capacity down about 20% May YoY from all the players involved. That is very encouraging and everybody is participating, which is good as well, including Brazil. So I am encouraged by what I am saying, I am encouraged by stability in international bookings going forward. So we are expecting positive RASM inflexion in 2H TY.

Mr. Matt XXX: that is great thank you very much.

Operator: the next question comes from Mike Linenberg, Deutsche Bank.

Mr. Mike Linenberg: hey good morning everybody. Abhi I just want to go back to the point you made about RASM inflexion 2H 19. Were you specifically referencing the international market or are you referencing Azul as a whole? And could you actually give us some additional color on what you are currently seeing since we are seeing a kind of a lying share of the March quarter, give us a sense of maybe what you are seeing and how things are looking into the Easter week into 2Q?

Mr. Shah: hey Mike. I was specifically talking about international only. Just looking at the international booking curve demand and capacity cuts, and also you have got to remember the comps are pretty tough. 1Q LY the USD was 3.25, 4Q 17 the USD was 3.25 and now it is at 3.80. So we have some tough comps, the industry has tough comps really and those will start to turn 2H TY together with the capacity cuts. So for international I am expecting positive RASM inflexion in 3Q and 4Q.

For Azul overall I think the RASM for the year if you look at our margin guidance of 15.1 last year, 2018, going to 18 to 20, 3 points of that is coming from CASK and up to 2 points of that is going to come from RASK. So that is what you can expect for the whole year.

In terms of breakdown by quarter I think the largest YoY RASK quarters will be 2Q and 3Q primarily because of the truckers strike in May last year as well as the World Cup, and so I think that is going to be the most positive; but I think the other quarters are going to be pretty steady as well. So I think you will see 1Q similar in terms of RASM increase and then strong 2Q, higher 2Q, higher 3Q and 4Q also in the zero to 2 range. Again higher comps and remember, we are growing capacity 18 to 20% with larger aircraft. So to be able to continue to increase RASM like we did last year to do it again this year with 18 to 20% really shows strength of the market and the strength of our network.

Mr. Linenberg: okay and then Abhi that actually leads to my second question which is 18 to 20% that presumably Azul net... as the plan stands today, as it stands today; but now... assume some assumptions of Avianca Brasil assets due to the two... part to that one, how does that change the potential growth trajectory? I realize... the cart is in front of the horse here; but then the second piece to that is that how are things trending on Avianca Brasil? I mean I realized you may not have the best information; but the concern would be that you assume a lot of assets and you assume some additional routes and there has been a significant fall off in bookings and so in order to get the passenger levels back to where they were before Avianca Brasil filed bankruptcy you have to engage in considerably fair activity. So I realize that is a kind of... conflicting; however you can answer that? Thank you.

Mr. Shah: I will give it a crack and then I will let John and David jump in if they want; but in terms of the capacity growth it already includes some of the anacondas that Avianca voluntarily exited as part of their transformation plan. So some of these aircraft are already contemplated in these 18 to 20%. So this is a low single-digit worth aircraft that is already in there as part of what we announced in the early considerations a couple of months ago.

In terms of their booking again, I do not know what their bookings are, I do not have the ability to know what their bookings are, so it is a sort of hard to answer that. I do think just looking from a commercial perspective that the Azul announcement will give the market to have confidence in Avianca and confidence that they will continue to serve many of their routes, and I think that should help in bolstering Avianca's bookings - but again I do not have access to the numbers, I cannot have access to the numbers and so I cannot really answer that in details. But I do think the market overall thanks to our announcement and this partnership is sensing support and confidence in Avianca and that will and should help their bookings.

Mr. XXX: first I think as mentioned earlier they have definitely more routes than what we are anticipating putting into the new codes. So obviously we had a pretty good indication of what routes they were doing better on and which ones they were doing worse on. So overall as we said earlier there is going to be a cut in the capacity of the market and no matter how you shake it. So with less seats flying even with our growth we found last year so that should help make the transition.

Mr. Linenberg: very good thanks David, thanks Abhi.

Operator: the next question comes from Andressa Varotto, UBS.

Ms. Andressa Varotto: hi thanks for the opportunity. Two questions, the first on jet fuel. We saw Azul's jet fuel prices 21:07 expanded 7% QoQ while oil jet prices decrease around 10%. Is this related to a delay... effect to Azul and should we expect a reversal in the next quarter? Thanks.

Mr. Rodgerson: I will let Alex walk through the details; but you have to remember that brand and WTI fall a lot quicker than we see the benefit, because there is a lag in Brazil, about a 45 day lag. The one I walked through this Alex?

Mr. Alex Malfitani: yes. As John mentioned there is a 45-day lag and that works obviously on the way down and on the way up as well. So whenever you see on the screen in general, on average it takes 45 days for it to start reflecting the fuel price that we actually pay into our planes. WTI and Brent they have a bigger crack spread to jet fuel and so we also tend to look more heating oil because it has a stronger correlation with jet-A , which is what we actually buy.

On December 31 these prices were about 20% lower actually than where they are today; but there was a lot of change in prices within 4Q. It was a volatile year overall in 2018 when 4Q was also volatile. So December 31 was 20% lower than where we are today and so you can do the math and see how that will reflect into our prices. We are hedged at... 30% of our next 12 months and our average prices we are open in the money, even though we were out of money in December so today we are slightly in the money. So our average price is better than what you see the market today. So I think with that info you can probably figure out where our prices are going to be.

Ms. Varotto: okay thanks very much. Secondly we saw reduction in maintenance expenses in the quarter compared to the historical level and if this is something that should continue going forward and if yes if it is included in the Ebit margin guidance and how much it would represent? Thanks.

Mr. Malfitani: so first 4Q specifically a couple of factors. We have been talking about it. We have been investing in spare parts inventory; we have been investing

in insourcing some of our maintenance activities. This all makes sense because we are now bigger, we get... critical mass where it does make sense for us to do that. Also we have a lower cost of capital.

Also in the old accounting policy IAS 17 we would expense some maintenance on leased aircraft as occurred right? So when we had the maintenance event that is when we would recognize the maintenance expense and that creates some lumpiness between quarters; there are quarters with more maintenance expense and quarters with the last maintenance expense; 4Q obviously was a quarter with less maintenance expense particularly on engines.

Going forward IFRS 16 really changes a lot of this because some of the maintenance expense on leased aircraft that we were recognizing as Opex will become Capex. So our maintenance expense overall next year will be lower than this year, and even if you take into account the fact that they are growing it would be normal for it to be higher and will be nominally lower than what it was in 2018 mainly because of IFRS 16 and that is embedded in our CASK guidance of -1 to -3.

Ms. Varotto: very helpful thanks very much.

Operator: our next question comes from Dan Mackenzie, Buckingham Research.

Mr. Dan Mackenzie: okay good morning guys thanks for the time here. I guess the first question I am wondering if you can help us understand how the debt picture changes for Azul if the scenario were successful on acquiring Avianca's assets. So how much debt does Avianca Brasil have today and how much of that would follow under a deal closing?

Mr. XXX: Dan as we explained we were actually acquiring what is called an UPI in Brazil or a new company. So all that would go in there. It is just the operating leases that would need to be renegotiated and so there is actually no debt associated with the acquisition.

Mr. McKenzie: okay that is clarifying thank you and I guess when we think about deal economics how does it change Capex plans for this year and next year? And as you think about Avianca's working capital needs does it require more cash on top of what you are proposing at this point?

Mr. XXX: I actually think it gives us a lot of flexibility. We see Avianca Brasil acquisition assuming it takes place - and we look forward to doing that - is those 30 aircraft the majority of those aircraft are going to come in at shorter term leases, which will actually be replaced with our Neos that will be coming over the next couple of years. So it really kinds of accelerates a couple of years our growth; but

then we can countermeasure growth going forward the way we extend these leases through actually just return the leased aircraft and bring in our Neos. So I think it is a way to reduce the risk going forward as we already get pilots and flight attendants and maintenance technicians already ready to go. They are already trained under specific aircraft that we are growing over the next couple of years. So that is the way we look at it and so I think of it as a kind of pull forward our growth in a couple of years; but then what happens with the Neos that come in and most likely the Ceos 09 come out as a result.

Mr. McKenzie: understood and then maybe I could just squeeze one or two more in here, quick ones. I guess first I think you could help us understand a kind of the two big risks at acquiring another airline is typically IT and labor and I am just wondering if you could just sort of comment around IT compatibility, lack of IT compatibility, how you are thinking about that labor.

And then just secondly foreign exchange has been a stubborn headwind here. So for those investors that do not know Brazil well how are you handicapping the potential for economic and fiscal reform later this year? 99% probability the big stuff gets passed, maybe 50%? The big picture how worthy initiatives that are critical to Brazil economic growth being pursued by politicians?

Mr. Shah: hey Dan I will talk about the IT stuff real quick. So we obviously had some good experience with this with the Trip merger. Trip at the time had the same reservation system and we of course have... but we were able to transition that pretty quick. I think we had the code shared and the flight in one system within six months. So certainly not... We have done it before. Avianca has the Amadeus reservation system, which Azul also has as part of our code sharing alliances platforms. So we feel confident regarding the IT. It requires some work but nothing we have not done before or do not know how to do.

Mr. Rodgeron: Dan from the culture impact taking on crewmembers from another airline Azul is strong today and Avianca is significantly smaller than we are. We by far have the best product and experience in Brazil; but I would tell you that Avianca Brasil is a close second. I think they have fantastic crewmembers and they have fantastic, have run a great operation. I think that Azul coming in is probably very welcome. There has been a lot of uncertainty at the airline over the last six months at least two may be longer and so I think that it has something that we are willing to manage. David talked a lot on the call today about it is going to be the best job of your life - and I think that is what we have for the majority of our crewmembers and we intend to extend that to the new members of the family that would come in over the next couple of months.

With the Trip acquisition you walk through a company today and that has been five years, it is indistinguishable. You do not know if it is Azul or Trip because we have been able to assimilate them into our culture and it has been amazing to watch. So we do not think that is going to be any different with the crewmembers from Avianca into our company.

Mr. XXX: and then back to your other question on reforms something is going to get passed. I think it is going to be 100% of what everybody wants? Probably not but something is going to get passed. Everybody has been talking about at the government level and I think that the government is hyper focused on it and I think that we are looking forward to reforms that take place and I think you are seeing the military and everybody is kind of on board saying that this needs to happen. I think the states are behind it, think most the political parties are behind it.

Again I do not want to handicap it because we have to run our business and any time you have a business plan that depends on the government it is not a good business plan. So what I would tell you is we are going to continue to expand margins in light of what happens from a macro perspective; but it could not be more of the mystic about the changes that are happening in Brazil. We have gone through a couple of rough years in Brazil and so at least the government is focused on the right things right now and that gets is excited.

Mr. McKenzie: that is fantastic, thanks guys.

Operator: the next question comes from Savi Syth, Raymond James.

Mr. Matt XXX: it is Matt again, thanks for adding me back on here. Just a quick one. You guys gave really good color on the RASM trend throughout 2019. I was wondering if you average, some of your overall cost trends, how you are thinking about that through the year?

Mr. Malfitani: yes sure Matt. So as you saw we gave guidance on continuing our CASK reduction in 2019. We should go down between 1 to 3 p.p. I would say that is mainly from our fleet transformation. As you know and we mentioned many times the CASK in the new aircraft goes down between 26 and 29% compared to our current aircraft right? It is important to note that a couple of specific things about 2019 first with IFRS 16 rent and some maintenance which are dollar-denominated they are capitalized and depreciated right? So that should reduce volatility to FX.

So as you model you will see less sensitivity obviously in the short term and that gets added to the balance sheet and depreciated over time. Also this year we have the payroll tax that has gone away and it is coming back. It is coming back since January 1 and so that adds additional cost to our salaries line and so you will see

that starting 1Q that line is going to be bigger - but that is included in our 1 to 3 CASK guidance. We are going to look for other opportunities beyond fleet transformation to continue running a more efficient airline and reducing costs and finding any kind of opportunity that we have to take costs out of the company.

Mr. Matt XXX: great thanks guys.

Operator: our next question comes from Lucas Laghi, Citibank.

Mr. Lucas Laghi: good morning guys thanks for taking my question. My question is regarding the next tax of the joint venture with Correios after Cade's approval, when we could see impact of the JV in Azul's numbers? Thank you.

Mr. XXX: we received Cade approval d that is another step with government approval. It was a kind of, slowed a bit down a bit is we have had three different presidents that the Correios in the last 12 months. So any time government changes there is new leadership in that area and so for now we are focused on Azul cargo growing the business as quickly as we can. We are still very optimistic about the opportunity; but unfortunately we cannot give you much more update at this time because we are now working with the new leadership team and what the new joint venture would look like jointly with them. So maybe it takes some time to get up to speed as well. That is the latest we have.

Mr. Laghi: all right thank you guys.

Operator: Ladies and gentlemen as a reminder if you would like to pose a question please press the star key followed by the one key on your touchtone phone.

Mr. XXX: okay I guess that is it for the questions. Again I would like to thank everyone for joining us and we all look forward to talk each time. If you have any questions our team is available, we are always open and we really are excited with our business and we are excited about the direction going forward and we will see you next quarter and we expect hopefully things will continue to improve and we will do our part. So thank you very much everybody.

Operator: Ladies and gentlemen that does conclude the Azul audio conference for today. Thank you very much for your participation and have a good day.
