

Conference Call Transcript
Azul
1Q24 Results

Operator

Hello, everyone, and welcome all to Azul's 1Q24 earning calls. My name is Zach and I will be your operator for today.

This event is being recorded and all participants will be in listen-only mode until we conduct a Q&A session, following the Company's presentation. If you have a question, click on the Q&A icon at the bottom of your screen and write your name and company. When your name is announced, please turn your microphone on and proceed.

For those who are listening to the conference on the phone, press nine to join the queue and six to accept the order when requested.

I would like to turn the presentation over to Thais Haberli, head of Investor Relations. Please, proceed, Thais.

Thais Haberli – Head of Investor Relations

Thank you, Zach, and welcome all to Azul's 1Q24 earnings call. The results that we will announce this morning, the audio of this call and the slides that we reference are available on our IR website.

Present here today will be David Neeleman, Azul's founder and Chairman, and John Rodgerson, CEO. Alex Malfitani, our CFO, and Abhi Shah, the President of Azul, are also here for the Q&A session.

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

These statements are based on a range of assumptions that the Company believes are reasonable, but are subjected 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 will turn the call over to David.

David Neeleman – Azul's Founder and Chairman

Thank you, Thais. Welcome, everyone, and thank you for joining us for our 1Q24 earnings call. First of all, I wish to express my solidarity with the people of Rio Grande do Sul during this very difficult time. We are deeply saddened by the loss of lives, the displacement of people and the widespread destruction caused by severe flooding in that region.

On a personal note, my family has deep connections to that region. My father has done business there for decades, my daughter served a mission for our church there and we have many dear friends.

Azul's crew members from all over the country have put their heart and soul into relief efforts, donating time, money and supplies while, at the same time, running the day to day operation. I have always stated that we have the best crew members in the world and they are once again proving it. I cannot thank them enough for their passion and their dedication. We have already received more than 1,300 tons of supplies and donations and the challenge now is to swiftly get the supplies to those who need them.

With that in mind, we have created, together with Itaú bank, a fund to enable as many dedicated flights and truck shipments as possible. I want to especially thank Milton Maluhy, the CEO of Itaú, for his partnership and support in these efforts.

Turning to our earnings presentation, I want to remind you of the fundamentals of our business. Our exclusive network and diverse business units combined with a growing, efficient and flexible fleet are key drivers to another record quarter of results.

One clear example of this is the fact that we continue to be the only carrier in 82% of our routes. Many thought that as we grew, we would have to encounter more competition, but in fact, the opposite has happened. We stayed true to our strategy, we grew within our network and, by doing that, the percentage of routes that we are the only carrier has actually increased.

On slide five, we show one great example of this effect is our focus city, Belém, in the North of Brazil. In the past, if a customer from the North of Brazil wanted to fly to another destination in the North, they first needed to fly South, the so-called V route, adding hours and sometimes more than a day to their journey. We saw that as an incredible opportunity to connect all of the North of Brazil via Belém.

Since 2019, only in Belém, we are up 70% in departures. Out of the 23 destinations served, we have competition on only five of them. This is just another of the many examples around the country of how we have been able to grow by finding and developing new demand. We are confident Brazil still has a lot more room to grow, and Azul will continue to explore that opportunity.

On slide six, we summarize Azul's ecosystem of business, which has powered our growth and diversified our strategy. In 1Q24, our core businesses of loyalty, vacations and cargo once again had solid results. For example, gross billings of our loyalty program increased 31% versus 1Q23. And our vacations business increased gross billings by 75% year over year, thanks to strong demand and leisure markets supported by our dedicated vacations network.

Even with all this growth in the Brazilian market since we founded Azul in 2008, Brazilians still travel significantly less than countries such as Colombia, Chile or Mexico, so imagine the opportunities we have to grow even more in these businesses.

In addition, we continue to ramp up our maintenance unit, Azul TecOps, our overhaul and maintenance unit. We have seen accelerated growth in our charter unit, Azul On Demand, as well. These fast growing high margin businesses strengthen our leverage in our business model and are a major factor in driving margin expansion.

I am proud to see the great strength of our Company. Once again, we are reporting record results and margin growth. We are doing all we can to help the people in Rio Grande do Sul at the same time, our laser focused on our business and our path through 2024 and beyond.

With that, I will now turn the time over to John to give you more details on our record first quarter results.

John Rogerson – Azul's CEO

Thanks, David. First, as David said, our heart goes out to all the people affected by the devastating floods in Rio Grande do Sul. I have been in contact with dozens of our crew members and we are doing all we can to support them during this difficult time.

I am so proud of all of our crew members for their incredible volunteer efforts, which are deeply appreciated by the people in the South. The culture and sense of family at Azul are stronger than ever.

One question I am sure you all have is: when do we expect the Porto Alegre airport to reopen? The answer is: we do not know yet and, of course, a knock and report are monitoring this difficult situation and we will determine when the airport can be reopened safely.

In the meantime, we are working with authorities to allow a limited number of commercial flights into the neighboring Canoas airbase. This will allow the industry to reconnect the region to the Brazilian airline network, enabling critical movement of people and supplies. We will keep you updated as the situation develops.

Focusing now on our results, as you can see on slide seven, we once again had a record quarter. Our operating revenue increased 4.5%, to R\$4.7 billion, driven by a healthy demand environment, robust ancillary revenues and growth in our business units.

RASK and PRASK stood at record levels for a first quarter, demonstrating the strength of our business model. Capacity for the quarter grew 2.6%, supported by a 6% growth in the domestic market, offset by a temporary reduction in our international network due to a transition in our white body fleet.

EBITDA reached R\$1.4 billion, a record for a first quarter and an increase of 37.4% compared to 1Q23. Our EBITDA margin of 30.3% was also a first quarter record and one of the highest in the world. It clearly confirms our ability to grow and extend margins at the same time. As David mentioned, as we grow, we get stronger and more profitable.

On slide eight, you can see the continued evolution of our EBITDA. Since 1Q19, our EBITDA has more than doubled, as the Company has grown, but now, our EBITDA margin has reached a record as well, to more than 30%. This is especially remarkable, given the fact that both currency and fuel are much more challenging today than they were in 2019. So, even with these headwinds, we were able to grow and expand margins, demonstrating, once again, the strength of our business.

On slide nine, I want to highlight one of our key initiatives to further expand margins this year and beyond: aircraft utilization. We have significantly increased aircraft utilization compared to last year, supported by strong demand throughout our businesses.

For example, our vacations business alone has doubled its dedicated route network. These flights allow us to increase utilization at non-peak times, while, at the same time, bringing us a whole new segment of demand. These are opportunities that we continue to develop and we are extremely excited with the progress we are making.

Looking ahead to the rest of 2024, I want to talk about a key driver of our growth and EBITDA expansion, our E2 deliveries. As you can see on slide 10, we will significantly increase the rate of E2 deliveries this year, with 13 new Embraer E2.

To remind you, the E2 has 18 more seats and delivers 18% lower fuel burn compared to the E1. This means we get a 26% reduction in our cost per seat. In summary, with this aircraft, we can have more revenue and lower cost compared to the first gen E1 that we are flying today. Today, we have 20 E2s flying, but, by the end of 2025, that number will more than double.

Slide 11 shows how relevant the E2s are becoming. In the next 12 months alone, the flights and capacity flow of nine E2s will more than double. The economics of the E2 allows us to fly longer stage length and more hours in the day. And as a result, drive significant operational leverage and margin expansion.

Azul will be a larger airline as we exit this year, our broad network and unique connectivity serve as the ideal platform for this profitable growth going forward.

Moving on to slide 12, you can see we have a consistent growth in EBITDA expansion over the last 15 years, only interrupted by the pandemic. But if you exclude that period, you could see that we are back to the earnest growth trajectory that we have always had, and there is more to go. Our 2024 EBITDA of R\$6.5 billion will be by far our best year ever, and still the best is yet to come. Our strong operational performance leads to improved cash flow and reduced leverage.

On slide 13, you could see that even in a seasonally weak quarter, from a cash perspective, the operation was able to generate enough cash to pay down aircraft debt, CAPEX and interest. We have also been able to invest in our growth with, for example, pre delivery payments for upcoming aircraft, which we know will come back when these aircraft are delivered.

In the second half of this year, the airline will be about 15% larger than it is today. Combined with favorable demand seasonality, EBITDA will be even higher, while the cash outflows will practically not change, clearly leading to improved free cash flow generation. As we annualize these numbers, you can clearly see that we are on the path to sustained cash generation.

As a result, as we show on slide 14, thanks to significant EBITDA generation in 2024 and continued pay down in debt, our leverage at the end of this year will be around 3, lower than what we had in the 4Q19. As we reach this milestone, we will exit 2024 as a truly stronger Company than we have ever been.

Concluding on slide 15, our business is doing extremely well, with record revenues and EBITDA. Going forward, our continued fleet transformation and increased aircraft utilization will lead to much higher growth in EBITDA than in lease payments or CAPEX. Our interest payments will also reduce as we pay down debt, and our cost of capital will improve.

This leads directly to higher cash generation, which is why we are so excited about the future. More importantly, our customers love to fly us and our crew members love to work with us. We are sharply focused on executing our business plan for 2024 and beyond.

With that, David, Alex, Abhi and I are available to answer your questions, and I turned the call over to the operator.

Questions and Answers

Operator

Ladies and gentlemen, thank you. We will now begin the Q&A session. Remembering that if you have a question, click on the Q&A icon at the bottom of your screen and write your name and company. When your name is announced, please activate your microphone and proceed. (Operator Instructions).

Let's go on now to the first question. It will come from Gabriel Rezende, sell-side analyst from Itaú. Gabriel, we will open your microphone so that you can ask your question. Please, proceed.

Gabriel Resende – Itaú BBA

Hello, everyone. Thanks for taking my questions. It would be great if you could provide some comments regarding the four bookings and the respective routes you are seeing at this point for the coming months, the months that you already have some visibility, mainly considering that Azul has been able to maintain routes at a very attractive level, increasing on a year on year basis,

despite what has been happening with cost and the favor effects on a year on year basis as well. That is my first point.

The second point, if you could provide some comments regarding potential supply chain risks that could challenge your expectations for the aircraft to be delivered this year. I understand this might be a key point for your guidance and expectations regarding fuel savings as well. Thank you.

Abhi Shah – Azul’s President

Hi, Gabriel, I can take the first part. Overall, we feel pretty good about demand. We are in the middle of 2Q24, so there is a second quarter seasonality, which is very similar to last year. So I expect a similar flow RASK this second quarter to the last second quarter, but we are seeing really good momentum in terms of future sales.

I will give you some highlights here for the month of April. We had 100% recovery in corporate volumes versus pre-pandemic. We had a 40% increase year over year in corporate volumes versus last year and a 40% increase in leisure volumes versus last year as well.

So, looking ahead to the middle of June, end of June, July and onwards, we feel pretty good about how the curves are building and how the demand is kind of moving forward. So I would say second quarter seasonality is very similar to last year, but a really good month in terms of forward bookings, like I said, up 40% in the month of April and looking ahead.

John Rogerson – Azul’s CEO

On the supply chain issue that you highlighted, we have a great partner in Embraer, we have great partner in Airbus, as well as ATR, and we are closely tracking the deliveries this year, and we were assured by our partners that all the deliveries we are supposed to get will happen on the new schedule, so they are more back and loaded than we would want.

However, that is why we are exiting 2024 a much larger airline which rolls forward to 2025. That will be a much larger airline going into 2025 because of the backend nature when the aircraft will deliver.

I just want to remind everybody that all of our engines are under power by the hour agreement, which is a strategic advantage at this time in the industry. People that do not have deals locked in with the OEM, it is a strategic disadvantage and all of our engines are now under a long term agreement with the OEMs, which means we have got great partnerships in the ability to grow going forward.

Victor Mizusaki – Bradesco

Congratulations for the quarter. We have two questions here. The first one is a follow-up with regards to the aircraft deliveries. John, considering that the deliveries are back-loaded this year, what does this mean in terms of capacity growth for 2025?

My second question is whether you can comment about a potential deal of Gol or the negotiations with Abra. Thank you.

Abhi Shah – Azul’s President

Hi, Victor. About the aircraft for this year, I think our guidance for capacity growth was 10 to 11%. There is going to be a little bit of an impact now with the Porto Alegre network, so I think 10 to 11% is a good number for this year.

When you then take the aircraft that we are expecting in the second half and beyond and you annualize that towards next year, you can expect a slightly higher rate for 2025. We do not have 2025 guidance yet and, of course, we are still closing the fleet plan, but this year, between 10 and 11%, and a little bit above that for 2025 versus 2024 in terms of overall ASK growth.

John Rogerson – Azul’s CEO

Victor, obviously, we cannot comment on the news reports. The only thing I will say is that we believe strongly in what Azul's building, we believe strongly in what we have going forward and we are big fans of consolidation. I think that that is also something that we have been pretty open about for the last five years or so. So, we will see what happens going forward. There is a process in place, and we are watching very closely. That is all we can really say.

Savi Syth – Raymond James

Our first question is: can you comment on what you are seeing in the domestic market in terms of competitive capacity?

Abhi Shah – Azul’s President

Absolutely. Regarding competitive capacity, we see a pretty mild competitive capacity, environment and discipline. We think overall capacity growth this year is going to be low single digits for the industry overall. We are not seeing any large variations from any of the players, so it feels pretty disciplined overall. I think everybody is focused on results.

And even the allocation of capacity within the networks, as I have said many times before, I think airlines are focusing where they are strong and I think that is providing the best results for each one. I think that is the best for the consumer and for the industry overall.

If you were to model the whole year domestic market, I would say overall capacity growth this year a little bit now Porto Alegre puts that in doubt, but I would say low single digits.

John Rogerson – Azul’s CEO

I just want to highlight that the OEM issues that exist with engines across all of the engine manufacturers are making it really tough to add capacity in the short term. And you know, Airbus

and Boeing are having issues delivering aircraft on time, so I think that keeps capacity in check for the foreseeable future as well, which makes for a healthy environment.

Savi Syth – Raymond James

Thank you. And then just one more quick one: Do you have any color on cargo demand as well?

Abhi Shah – Azul's President

Cargo continues to be sideways, I would say. Internationally, we are seeing strong demand but we have not seen a return in cargo yields. International cargo yields are still low and I think many airlines that have reported so far have already commented on that.

Domestically, we are growing, which is good. We see strength in our partnership with ecommerce players like Amazon, for example. Amazon had a press release about Azul a couple of weeks ago, so we are growing with them.

I would say growth is going to be in the mid-single digits this year, which is still a positive scenario compared to many airlines around the world that are still reporting negative cargo revenue growth.

So, I would say domestic growth is in the mid-single digits, internationally there is good demand, but yield is still soft and we haven't seen it. So, I would say kind of mid-single digit growth on the cargo side.

Alberto Valerio – UBS

Thank you very much for taking my question. First, I would like to congratulate Azul's team for the initiative that they are doing in Rio Grande do Sul.

I have two questions. The first is about the seasonality of the year. Usually, we have a first and second quarter very close to each other. Last year, we had a slightly worse second quarter compared to the first quarter. I would like to see how this year will be.

My second question is about the cash generation for the year. We are at the beginning of the year, we are forecasting a zero cash burden for the year. If you can keep thinking that way, we have slightly negative numbers for the quarter compared to our numbers. I think R\$200 million is the difference. I would like to see if you can still keep this cash generation at zero for the year. Thank you very much.

Abhi Shah – Azul's President

Hi, Alberto. On the seasonality, yes, this year, as well, we will have a 2Q slightly below 1Q levels, very similar to last year. And then the rebound in 3Q and 4Q. Last year, we had many holidays in 2Q23, especially in April. This year, we have much fewer holidays, which is good from a bookings perspective. We are seeing significantly higher bookings, especially with the more days available.

But we are seeing a more diluted revenue environment, just not as peaky, not as many peak days as we had last year.

So overall, we will have similar seasonality to last year, 2Q24 slightly below 1Q24 and then a rebound in 3Q24 and 4Q24, which is normal for Brazil.

Alex Malfitani – Azul's CFO

Alberto, on the cash, we are very excited. I think this is a year where you are starting to see everything that we have built and everything that the strong EBITDA generation can provide. And you can see by the slide that we provided kind of using the direct method, right?

You can see that our EBITDA in a seasonally unfavorable quarter in terms of cash like 1Q was enough for us to pay everything that we have to pay. We generate a lot of cash inflows from the operation and that is enough for us to pay for all of our rent, to pay for all of the interest, all of the CAPEX.

Normally, in a seasonally unfavorable quarter, you could even burn a little bit of cash on that basis of free cash flow to the firm and still generate cash for the full year, especially the way that Abhi talked about the seasonality. He talked about first quarter and second quarter, but also you have to think about how the first half is different from the second half, in terms of when the capacity growth is coming, what is the fuel curve for the year.

Clearly, fuel is going to be higher in the 1st and 2nd quarter, and it is going to be for the 3rd and 4th. And just the natural demand seasonality that you have during the year, you always have demand accelerating into the third quarter and fourth quarter.

So we are breaking even in a quarter like 1Q24, and we are very excited about what the result is going to be for the full year.

And we reaffirmed our leverage guidance for the year. We will be below the leverage that we had in 2019 in the pre pandemic, which gives you an estimate for what the cash position is going to be.

We are very excited for 2024. But if you start doing this math for 2025 and 2026, the number that we're going to generate this year, which will be a positive number, can increase by about a billion every year after that. It is not that we turn positive this year and then stay at those levels.

EBITDA generation is going to continue to grow. And, as you know, we don't really have a lot of increased fleet costs. The CAPEX is what it is, the rent goes up, but it doesn't go up as much as EBITDA, it doesn't even go up by as much as capacity, because some of the capacity growth comes from the up gaging of E1s into E2s and A320. Some of it comes from increased aircraft utilization as we described.

So, the revenue growth and the capacity growth are going to outpace growth in rent. When you do that math, you can see the significant jumps in the cash flow generation year over year going forward, especially as the airline just gets larger, with all these E2s that we are talking about.

Rogério Araújo – Bank of America:

Good afternoon. Thank you very much for the opportunity. My first question is about one-off costs and expenses. The Company had been reporting 5-7% of revenue in one-off costs in the previous quarters, but now it was zero, and this led to a strong margin gain when including this one-off expenses. My question is: how should we think about it in the upcoming quarters? Should it continue to be close to null?

The second question is on the 2.6% capacity expansion in the quarter. You talked about a temporary reduction because of international capacity on this white body fleet transition. If you could give us more detail on that, it would be great. Thank you.

Alex Malfitani – Azul's CFO

A lot of the non-recurrent that you have been seeing in 2023 was related to the restructuring. We were deeply in restructuring mode last year, and that caused restructurings in the fleet and in the lease payment schedule. Obviously, a lot of one-time fees to advisors and a lot of fees for new issuances. Going forward, unless there is anything that is actually extraordinary, we do not expect to have anything relevant in terms of one-time adjustments.

Abhi Shah – Azul's President

Rogério, on the capacity growth, we had a big impact this quarter from the International Widebody fleet. To give you more detail, we had our two A350 that were flying there as part of the restructuring from last year were returned to the lessor at the end of January. So they exited the fleet.

We have four A330s coming to replace them, but, due to the transition of the fleet, they are coming now. So one is already flying. It started flying in April. The second one is going to start flying in the first week of June. The third one is going to start flying in the third week of July and the last one at the end of August. So that is why you have the slow ramp up in capacity.

You have the dip that was February, March and April, and then you have the recovery in international capacity as we go through 2Q24, 3Q24 and 4Q24. So that is on the international side, we basically have two Widebodies leaving the fleet at the end of January and then we have four coming in.

We also had some heavy maintenance calendar timing. And then, as John mentioned, we have the E2s coming in the second half of the year. That is going to provide some capacity for this year and then for next year. But that is the detail on the widebody fleet.

Operator

This closes our Q&A session for this call. We will move the call over to John for his closing remarks. Please, John.

John Rogerson – Azul's CEO

I appreciate everybody and look forward to seeing many of you in New York this week. And, once again, let's pray for the people in Rio Grande do Sul. It was very catastrophic what happened there. Rest assured that Azul's doing all we can to help, as we run a fantastic business.

We continue to grow this business going forward. We feel very strongly about what we built, and we are going to continue expanding margins and generating cash on a going forward basis. Thanks everybody.

Operator

Thank you. This concludes Azul's audio conference call for today. Thank you very much for your participation and have a good day.