Conference Call
2Q23 Earnings Results
Aug 10, 2023

Operator

Hello everyone, welcome all to Azul's First Quarter Earning Call. My name is Zach and I will be your operator for today. This event is being recorded and all participants will be in a listen-only mode until we conduct the Q&A session, following the Company's presentation. If you have questions, 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 on your microphone on, and then proceed. (Operator Instructions).

I would like to turn the presentation over to Thais Haberli, Head of Investor Relations. Thais, you may proceed.

Thais Haberli - Head of Investor Relations

Thank you, Zach, and welcome all Azul's Second Quarter Earnings Call. The results that we announced this morning, the audio of this call and the slides that we reference are available on our IR website.

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

Before I turn the call over to David, I'd like to caution you regarding our forward-looking statements. Any matters discussed today that are not historical facts, particularly comments regarding the Company's future plans, objectives and expected performance, constitute forward-looking statements. These statements are based on a range of assumptions that the Company believes are reasonable but are subject to 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?

David Gary Neeleman – Azul’s Founder and Chairman

Thanks, Thais. Welcome everyone and thanks for joining us for our second quarter 2023 earnings call. 2Q23 was one of the most important in our history. I could not start without recognizing the impressive work of our leadership team. In 2Q23, we made significant progress on our comprehensive and permanent capital optimization plan leading to a successful conclusion in July.

John and Alex, together with their skillful teams, successfully implemented our plan, which included new agreements with lessors and REMs, an exchange offer and a new money raise. John will give you more detail later. It is absolutely incredible what they were able to achieve, all of this in just a six-month window.

I also want to thank all of our partners and investors who supported us throughout this process. Together, we have delivered a true win-win solution that we promised on the outset, one that is value maximizing for all stakeholders. I thank you for your vote of confidence in our Company and in our future.

Finally, and most importantly, I have to thank our passionate crew members, who continued to deliver excellence every day. Without our industry leading operation, customer service and a Company that produces over R$1 billion in EBITDA per year, none of this would have been possible. Thanks to their continued efforts, we are now in a position where we can put the crisis behind us and we can focus on the future.

Turning to slide four, you can see that our network is stronger than ever. Our superior business model and structured competitive advantage allow us to connect all of Brazil. We are the only carrier in 81% of our routes and fly to over 160 destinations, three times more than our competition. We are the leader in more than 90% of our routes, which supports our industry leading profitability.

During 2Q23, we launched our expanded Congonhas service, more than doubling the daily departures, now serving all of the top corporate destinations. In addition, we launched our newest international destinations, Paris and Curaçao, both of which are off to a very strong start.

On slide five, you can see the outstanding performance of our business units in 2Q23. Our loyalty program, Tudo Azul, more than doubled in gross buildings versus 2019 and is clearly benefiting from our new Congonhas flights. Sign ups to the program have increased more than 80% since we launched our expanded Congonhas schedule.

I could not be prouder of our vacations business, which has had another exceptional quarter, with more than a 40% growth in gross buildings compared to the 2Q22. This business is now four times the size in terms of net revenue than in 2019. Azul Viagens is the second largest vacation agency in all of Brazil and we continue with our strong growth, expecting to double our stores to more than 100 by the end of this year.

Azul Cargo, our logistics business, continues to be the largest air logistics provider with the domestic market share of 34% and with net revenues more than double compared to 2019.

As I said, this is an important quarter for us. I could not be prouder of how the entire team has pulled together to deliver these amazing results for our shareholders. With that, I will pass the time to John to give you more details on our 2Q23 results. John?

John Rodgerson – Azul's CEO

Thank you, David.

I would also like to thank our crew members for their incredible work. Every day, I see how passionate and caring our people are for each other and our customers. It is this special culture that will fuel our Company for years to come.

Turning to the numbers, I would like to highlight our record results. As you can see on slide six, in 2Q23, we achieved record revenues for a second quarter of R$4.3 billion, 9% up versus 2Q22. Revenue in 2Q23 was up an impressive 63% compared to the same period in 2019.

Yield and RASK were also second quarter records at R$46.81 and R$40.42, respectively. Our EBITDA grew a remarkable 88% year-over-year, reaching an all time record for a second quarter of R$1.2 billion, with one of the highest margins in the industry at 27%, 11.4 percentage points higher year-over-year.

As you can see on slide seven, our EBITDA increased 58% versus 2Q19, even with a 60% increase in fuel prices. This is a clear demonstration of the strength and the resiliency in our business. Our structural competitive advantages combined with our rational and profitable growth allowed us to expand earnings in any macroeconomic scenario.

On slide eight, you can see that average fares were up 6% versus last year, while fuel prices dropped 24% year-over-year. It is a very positive sign as we transition into the seasonally strongest part of the year under a very constructive demand and pricing environment, in contrast to what you are seeing in other regions in the world.

As you can see on slide nine, we continue to effectively manage our costs with a 10% decrease in CASK year-over-year. This is mainly driven by the reduction in fuel prices and by our cost reduction initiatives and productivity gains.

Just to give you an example, a record 76% of our customers now use automated self-service tools for their check-in. In addition, productivity measured by ASKs for full-time employees has also increased, with the Company now generating 13% more ASKs per FTE than in 2019. And this is with an on-time performance of 87%. No small fee.

In addition, our fleet transformation of fuel savings initiatives resulted in a 4% reduction in fuel consumption per ASK compared to last year. We have the lowest CASK in the region, even with a diversified fleet and lower average aircraft size.

As we promised you, we are now a more efficient airline and better than ever. Azul has one of the highest EBITDA margins in the industry, as you can see on slide 10. The strength of our revenue performance, efficiency of our next-gen fleet, growth in our business units and world class customer service directly led to these results.

As David mentioned in the opening remarks, we have now concluded our capital optimization plan. This was an incredible achievement in such a short period of time and I join David in thanking our teams and our partners for their dedication and their support.

On slide 11, we remind you of the pillars of our plan. As announced before, we successfully reached agreements with lessors and OEMs to exchange COVID deferral payments into a combination of debt and equity. We also agreed with our lessors to make market-to-market adjustments on our leases, with any differences to the original lease rates also being exchanged for a combination of debt and equity.

Lessors and OEMs agreed to receive an unsecured tradable note maturing in 2030 with a coupon of 7.5% a year, an equity instrument convertible into preferred shares to be issued quarterly, installments starting at the end of 2024 with all issuances to be completed by the end of 2027, and minimal dilution to our shareholders of roughly 17%.

The next step in the plan was the restructuring of our debt obligation, which is why in June we launched a par-for-par exchange offer to extend the maturities of our 2024 and 2026 notes to 2029 and 2030. We successfully concluded this offer in July with an aggregate acceptance rate of 86% of the principal outstanding.

The final step was a new capital raise, which was concluded in July with the issuance of US$800 million in bonds maturing in 2028. The offer was three times covered, enabling Azul to obtain the lowest coupon among our peers in the region.

The success of our comprehensive plan clearly demonstrates Azul's ability to execute and represents a significant vote of confidence in our Company by the market and all of our stakeholders.

I just want to remind everyone that this entire process was done amicably with our partners and stakeholders, based on the guiding principle that our partners would receive 100% of what was committed to them. We always believed that this was the value maximizing solution for all, and I am happy to say that this is what we have achieved.

On slide 12, we show you the updated amounts related to the reduction in our lease payments resulting from our lessor negotiations. As you can see, we are reducing our annual lease payments by R$1.5 billion in 2023 and over R$1 billion in 2024, taking our recurring annual rent to below R$3 billion. In summary, the plan delivered the lease payment reductions we were targeting to optimize our cash flow and enable our future growth.

On slide 13, you can clearly see the runway that we have created. We have no significant maturities for the next five years, another key targeted outcome from our plan. Both in terms of yearly cash flow and future debt maturities, we overachieved versus what we expected. We now have a strong balance sheet and liquidity to match our industry leading operating performance.

As you can see on slide 14, the second quarter leverage organically decreased a full turn, from 5.2 to 4.2, as we paid down debt and increased our EBITDA. This is even more impressive considering it does not yet reflect the reduction in leverage expected from our capital optimization plan.

With the reduction in lease liabilities from our successful agreements with lessors, our deleveraging process will accelerate. You can see that by the end of the year, leverage will reduce almost another full turn to 3.5, in line with the guidance we gave last quarter.

We also remain with our expectations to end 2024 with the leverage of three, in line with our pre-pandemic levels. This leverage also includes the 2028 senior secured notes issued in July and the 2030 unsecured notes to be issued to lessors no later than September. As a result of the optimization plan, all three rating agencies have already upgraded Azul, reinforcing our financial health going forward.

On slide 15, we show our view on Azul's valuation. With our optimized balance sheet, positive cash flow, high liquidity, and earnings growth, our current multiple should be closer to our historical levels versus the 4.5 we are trading at now. There is a significant upside in our market valuation. I truly believe this and I look forward to having this discussion with all of you and our investors in the days and weeks to come.

Wrapping up on slide 16, I just want to remind everybody that our senior leadership team spent countless hours on this plan, and having successfully concluded it, we can now turn our efforts to our business and all of the opportunities ahead of us.

Our fundamentals are strong, our business model is unique, our upside is clear and, most importantly for me, our crew members are as passionate as ever. Once again, I want to thank all of our crew members, our partners, our stakeholders and our investors for all their support. What we have achieved together is remarkable and the best for Azul is yet to come.

With that, we are here to take your questions.

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 move on to the first question. It is from Filipe Nielsen, sell-side analyst from Citi. Please Filipe, we will open your microphone so you can ask your question.

Filipe Nielsen – Citi

Thank you very much, everyone, and thank you for taking my question. Firstly, congratulations on your results.I have two questions on my side. The first one would be on the international corridors. I know that, in Brazil, we have some backlog of issuing new US visas for tourists, but we know as well that there are some corridors that might be performing well.

In 2Q23, we saw you continuing to shift aircraft from cargo to international corridors using white bodies. So I would like to understand which are the markets and where you see more opportunities in terms of international.

And the second question would be in terms of the adjustments that you made on EBITDA in 2Q23. I just wanted to hear your thoughts and some extra clarification about the adjustments made in the EBITDA.

Thank you.

Abhi Shah – Azul's President

Hi, Felipe. Abhi here.

I can start with the first part about the international. You are right. We are happy with the performance of the international network. Our international capacity in 2023 will be larger than 2019, so we are fully recovered and more in our international capacity.

You are also right that, last year especially, we had some white bodies flying dedicated cargo missions to Brussels, to Fort Lauderdale, and even domestically in Brazil. We have now shifted them to our international long haul passenger network, and the market is holding up very well.

In general, what you are hearing from other airlines is true for us as well. The European market is doing better, but the US market is strong as well. We have great partnerships with JetBlue and United in the US, and with TAP and Air Europa in Europe. That allows us to feed lots and lots of cities beyond our gateways.

We have Campinas, our main hub, but we also have Recife and Belo Horizonte, so we are connecting our strongest hubs to the strongest hubs of our partners as well. Therefore, overall, we are very happy. Unit revenues are significantly higher this year than 2019 and we expect that to continue. So, overall, we are fully recovered and larger, and we are happy with the results in our international network.

Alex Malfitani – Azul's CFO

Filipe, on the adjustments, they are mainly tied to the capital optimization plan that we talked about. As you know, there were a lot of negotiations with lessors. In some of these negotiations, we were actually able to early deliver some aircraft that we did not want on our fleet.

And you all know how excited we are about our fleet transformation and how we want to replace all of our old generation Embraers, which were great for us to start the Company, but now we have much better aircraft on the Embraer E2 and the A320neos. In addition to that, with the demand the way it is today, there were some opportunities for us to accelerate the exit of some aircraft.

When you do that, you have some costs that are not recurrent, so you have to adjust, for example, the expected right-of-use that you had on that aircraft. You expected the aircraft to remain on the fleet for a certain number of years and, all of a sudden, it is not going to stay for that number of years. That creates a one-time impact on the P&L that is not recurrent.

Then, we remove that from the results so that you can have a better perspective on what the result of the Company will be going forward when we do not have that effect anymore.

We are proud of having followed the approach that we did with our restructuring as opposed to a more combative, longer and also more expensive approach that some of our competitors took, but there is still some cost. You still have some advisers, lawyers, and one-time fees involved in the structure, so we also removed those. Those are the main drivers of the adjustment that we had in 2Q23.

John Rodgerson – Azul's CEO

Azul has 185 aircrafts and almost every single aircraft was renegotiated. And, as Alex said, some were redelivered early and that it is just kind of part of the process, but we feel very good about where we are at. We had the ability to have a few E1s exit earlier, so we are very confident that, going forward, we will be able to continue to kind of expand margins even further.

Filipe Nielsen – Citi

Great. Thank you very much.

Operator

The next question comes from Victor, sell-side analyst from Bradesco BBI. We will open your audio so that you can ask your question. Please, proceed.

Victor – Bradesco BBI

Thank you. Congratulations for the results and the restructuring.

I have two questions here. The first one is related to your fleet plan. Now that you have concluded all the restructuring, could you give us additional details about the fleet plan for this year and the next?

My second question is related to block hours. We can see an improvement, but if we compare it with a pre-COVID level, you talked about something at around 11 hours per day and now it is 9.8. So, how fast do you believe that it is possible to reach this kind of asset utilization level?

Thank you.

John Rodgerson – Azul's CEO

Starting quickly on the fleet question, obviously, all the OEMs are late, including Embraer, Airbus and others. We expect Embraer to fix most of their issues by the end of this year and into next year, so we have a significant amount of E2s coming in to replace older generation aircraft.

Every time we take an E2, currently, it is the most profitable thing we do because we get rid of the E1s, upgrading that aircraft even further from 118 seats to 136 seats with fuel burn, that is about 25% lower per seat, so we are pretty excited about that. The next couple of years are really the E2 years for Azul, so you are going to see a significant improvement in the fleet going forward.

Now I will let Abhi talk about the utilization.

Abhi Shah – Azul's President

Hi, Victor. We did make improvements in utilization year-over-year up 6.8%, 7%, which is a very good sign. It is a reflection of the fuel prices coming down as well, which allows us to add more flying on weekends, more flights at night, stretching out the day.

We are making our way back to pre-pandemic utilizations. We will continue to see sequential improvement in this number in 3Q23 and 4Q23 as well, as we redesign the network and we take advantage of all the pockets of opportunity out there.

We do have to be a little bit careful because fuel is still higher compared to pre-pandemic levels, so we want to make sure that, as we stretch the day out, we do not lose the quality of the revenue.

Therefore, that is the balance that we are striking when it comes to utilization, but I fully expect that we are going to continue to make progress over the next quarter, as you will see us getting closer to that 11-hour number.

John Rodgerson – Azul's CEO

This is the big debate internally. Alex and Abhi have this every single day, so we know that is the greatest leverage we have. Increasing utilization is going to decrease our CASK overall and make us a more profitable Company going forward.

Victor – Bradesco BBI

Thank you.

Operator

Thank you. The next question will come from Gabriel Rezende, sell side analyst from Itaú BBA. We are going to open your microphone so that you can ask your question, Gabriel. Please, proceed.

Gabriel Rezende – Itaú BBA

Thank you, and congratulations on your results.

I would like to talk a little bit about profitability, given the strong 27% of the margin that we saw in 2Q23. I have two questions on that front. You managed to reach this strong level despite the second quarter weakness seasonality factor.

So if you could just touch on your view on what levels we should be thinking about in terms of EBITDA margins looking forward, considering the improving operational leverage it might reach in the second semester, that would be great.

And also on this subject, if you could provide a little bit of more color on your personnel expenses. We saw a 26% increase year-on-year, which was higher than the increase in ASKs in the period, both quarter-on-quarter and year-on-year. So, should we expect the level to be maintained in the next quarter as well or was there some one-off effect in 2Q23 that should not repeat going forward?

Thank you. Those are my two questions.

Alex Malfitani – Azul's CFO

Thank you, Gabriel.

We are confident in the R$5.5 billion EBITDA guidance that we gave out. The guidance that we gave on EBITDA on capacity and on leverage are all still valid. We had things moving in different directions. We had the PIS/Cofins that was approved, which is positive, and we had the fuel curve moving up, which obviously is a headwind.

However, like John said, we have so much opportunity that we want to tackle that we are confident that we can deliver on a R$5.5 billion EBITDA for this year and that is what we are going to be working on for the next few months.

And then, we will make sure that we have great momentum going into the next year, where the EBITDA can expand even further, at least starting with a six which is something that we are very excited about.

The second half is where most of that profitability comes from because that is how our seasonality works, as you pointed out. The second quarter is the weakest quarter in the year, and now we are entering a third quarter, which is gonna be better than the second, and then fourth quarter, that is going to be better than the third, which is something that is very exciting.

And still, in terms of EBITDA production, as we pointed out, we are at our record, but there is still upside on the margin. We are still working to recover margins. Our 2Q23 margin was still lower than 2Q19 and, even delivering on the R$5.5 billion EBITDA for the year, it will still be a lower margin than the margin that we had in 2019. That is why we are excited about 2024 and beyond because we want to get back to that EBITDA margin that we had in 2019.

And I think we can go even farther because we did not have the performance in 2019 of the business units that we have today, we did not have the 80% plus of next generation capacity and we did not have Congonhas. So there is a lot of opportunity for us to go even beyond the margin that we delivered in 2019.

John Rodgerson – Azul's CEO

I also referenced in the script that we now have the full focus of our management team on running the business, as opposed to fixing the balance sheet. So, as you look at how we fully optimize TudoAzul, how we fully optimize the utilization levels of the airline, how do we get as much out of all these business units and so on, that is how we are going to move forward.

However, again, as I said previously on the fleet plan question, there are a lot of E2s coming. Those E2s are very profitable and there are more A320s coming. We are exiting out, we still fly more E1 flights a day than we fly E2 flights a day. So that is a significant amount of upside going forward.

Alex Malfitani – Azul's CFO

On the personnel side, let me give you some guidance. I think it will help you with your estimates for the rest of the year. It is a tough comp in 2Q23 because of what happened in 2Q22. We had phantom options as part of our long-term incentive plan and they are very volatile. That is one of the reasons that we are going back to regular options as part of our long term incentive.

However, last year, when the stock price went down in 2Q22, the market was getting nervous, and that actually reduced our personnel expenses because we recognized a reduction in the long term incentive expense accrued. That should not happen anymore going forward.

Right now, with actual stock options as part of our long-term incentive, you just calculate the cost of those options and then recognize that, over time, the volatility is a lot lower. We are also going to get economies of scale because, obviously, we are going to fly a lot more.

Abhi talked about the increased utilization that we are going to get in 3Q23 and 4Q23, so you can look forward to a reduction in labor CASK from 2Q23 to 3Q23 and 4Q23, probably in the mid to high single digits. You will see our labor CASK going down into the back end of the year.

Gabriel Rezende – Itaú BBA

Thank you, Alex. That was very clear.

Alex Malfitani – Azul's CFO

Thank you.

Operator

Okay, so let's move on to the next question wich will come from Savi Syth, sell-side analyst, Raymond James. Savi, we are going to open your microphone so that you can ask your question. Please, proceed.

Savi Syth – Raymond James

Hello and good morning everyone.

I was curious about the domestic market. I appreciate the color you get in Filipe's question on the international but, on the domestic market, I was wondering if you could provide a little bit more color on leisure versus business. I have noticed that capacity is being mostly kind of trimmed as you get closer in, so I would like some updated thoughts on kind of capacity growth here in the domestic market.

Abhi Shah – Azul's President

Hello Savi. Yes, absolutely. We feel really good about the trends that we are seeing coming out of 2Q23 into second half seasonality. July, especially, was very resilient in terms of flown unit revenues and bookings as well.

Therefore, in terms of domestic demand, for example, in the last four weeks, in two of them, corporate volumes have been 100% of 2019. So this is the first time I can confidently say that we have actually recovered 100% of corporate volume.

Now, average fares are up 40-50%, so corporate revenue is up 40-50%, but, in terms of volume, it is very good to see that we have now recovered 100%. And this is a sample of four weeks, two out of these four and the other two are very close.

Regarding the pricing environment, I think the industry is doing everything correctly in terms of what needs to be done to take advantage of second half seasonality. Obviously, the run-up in fuel as well.

Our booked average fares in the month of July were higher than last year and that is with the reduction in fuel year-over-year. Now, our booked average fares are 30% above what we were seeing back in May. So I think the trends are very positive.

And, finally, on the capacity side, as you correctly said, capacity is being trimmed. Year-over-year, capacity in the second half of the year is actually lower than what we saw in 2Q23, so we are going to be entering a favorable demand environment and a favorable pricing environment.

The industry this year, domestically, is going to grow less than what the US domestic market is doing. We are going to grow about 3% versus 2019. 3% growth over four years, it is about roughly half what the US market is doing and that is why we feel good about continuing to increase RASKs.

Last year, tough comps, all time record RASKs, but we think things are set up to kind of repeat that this year. So, essentially, the demand environment is very solid, the pricing environment is solid and a favorable capacity discipline as well.

Savi Syth – Raymond James

That is super helpful. If I might ask, I know the cargo environment has softened but it seems like it is still healthy. I am just curious about what the revised plan is for setting up the logistics unit that you were working towards.

Abhi Shah – Azul's President

Yes, you are right. It is the international cargo, especially, that is weak. We have seen reports from LATAM, Avianca, Turkish, UPS, showing that it is mostly international cargo that is down, especially on the yield side.

Our domestic logistics business keeps growing. It is growing about mid to high single digits and that is still very encouraging. And also remember that our freighter exposure is very limited. We have 2737 freighters and a couple of four E-Jets here in Brazil, all for domestic purposes.

Therefore, we still continue to believe that Azul Cargo will transform logistics in Brazil. There is still a huge opportunity in getting e-commerce out to the rest of the country. So, domestically, it is still growing, not as fast as last year, but we are still about 2.5 times bigger than in 2019.

International is a challenge. It is going to be a challenge, but we are 85% domestic and that continues to be our focus.

John Rodgerson – Azul's CEO

In addition to that, Savi, I think there was a boom post-COVID international that everybody got to ride that wave, but it is the network we built domestically that is the strength of our cargo business.

That is the greatest advantage we have, the fact that we fly to 160 cities in Brazil compared to 50 of our next closest competitor, and the majority of those 50 cities that our competitors fly to is really truck cargo. So we are flying all throughout Brazil and that is the advantage that we have.

Savi Syth – Raymond James

Super helpful. Thank you.

Operator

The following question will come from Michael Lindberg, sell-side analyst, Deutsche Bank. We are going to open your microphone, Michael, so that you can ask your question. You may proceed.

Michael Lindberg – Deutsche Bank

With respect to the release, Alex, you talked about finalizing, in September, your agreements with the lessors and the OEMs. Presumably, that is just dotting your I's and crossing your T's. Is there anything else in that matter that we should expect, like with respect to CAPEX? Later this year, what are your Capex plans for next year? What else needs to get done, other than maybe what you have shown in the release here?

Thank you.

Alex Malfitani – Azul's CFO

Thank you, Michael. Not much. It is a bit of dotting the I's and crossing the T's and it is also issuing the unsecured 2030 note that is part of the negotiation with the lessors, implementing the equity instrument that we negotiated. Those are all kinds of conditions subsequent to all the agreements that we have signed, but then now we need to deliver on those mechanisms.

Regarding CAPEX, this year is still going to be lower than sort of our recurrent CAPEX here. In terms of recurrent CAPEX for remodeling, we talk about something in the R$1.8 billion or R$2 billion. To remind everyone, this is all maintenance CAPEX. We do not have CAPEX coming from new aircraft because most of the aircraft that are coming are going to be under operating leases.

Over time, we would like to do some finance leases, but you do not need to expect any cash outflow from new aircraft. It is all about maintenance, especially engine overhauls.

John Rodgerson – Azul's CEO

If I could just add one thing, although the documentation is still being finalized, we are paying the new rents, we are acting under the new agreements and we have already had celebratory dinners with the lessors on the agreement because the capital raise happened in July, and this all kind of follows suit from there.

So no issues at all and, for full disclosure, we have one lessor we did not get over the line, which represents less than 4% of our total leases. Actually, as somebody just pointed out, it is 2.7%. We are still talking to them, but we are done, we have turned the page and we are moving forward.

Michael Lindberg – Deutsche Bank

One other question. Could you just tell me what your liquidity will be in rough numbers at the end of September? If I use sort of the R$5.5 billion as a base, which was the end of June, and you incorporate the US$800 million, there are probably some puts and takes there. What would be a good liquidity guide that you could provide us?

Alex Malfitani – Azul's CFO

We have some payments that we made right on the 2024 note. There was a 19% pay down on who accepted the exchange. We have some advances that we had gotten from one of our lessors and we are paying down some of our convertible debentures. So when you kind of bake all of that in, we are going to be between R$4 billion and R$4.5 billion.

Michael Lindberg – Deutsche Bank

OK. And then, just one quick last one. Your other revenue has obviously been an area of good strength for you. When I think about your vacation business and TudoAzul, it is down year-over-year, and that is obviously being driven by cargo. Can you tell us if we were to pull cargo out of that? What other ancillary businesses would be up on a revenue basis? Maybe rough numbers.

Thank you for taking my questions.

Alex Malfitani – Azul's CFO

Mike, just on that line, essentially, that is all cargo. There is a little bit of a charter on it. Everything else in terms of TudoAzul, Viagens, are on the passenger side. TudoAzul is growing a lot, Azul Viagens is growing a lot, and Cargo domestic is growing, like Abhi mentioned, but that line is basically cargo and charters.

Michael Lindberg – Deutsche Bank

OK. Thank you.

Operator

Moving on to the next question, it will come from Guilherme Mendes, sell-side analyst, J.P. Morgan. Guilherme, we will open your microphone so that you can ask your question. Please, proceed.

Guilherme Mendes – J.P. Morgan

Good morning, everyone. Thank you for taking my question.

I have two follow-up questions actually related to yield and fuel. At your point on passing through a few costs, how fast do you think you managed to pass through a potential additional increase on two prices? And, on the same topic, how do you think about your heading strategy going forward?

Thank you.

Abhi Shah – Azul's President

Hello, Guilherme.

I think that, at every turn, the industry has tried to do the right things and done the right things in terms of recapturing these costs. Of course, we have additional benefits in terms of controlling our own destiny because so much of our network is by ourselves, so we can always be testing and always be managing our own, not having to wait for the industry to catch up.

Then, I am optimistic. Just look at what we will be able to achieve in terms of average fares in 2Q23, a seasonally weaker 2Q versus a post-Omicron 2Q22, and we still had higher average fares.

So, with corporate demand coming back strong, our corporate survey tells us that corporations will fly more in the second half of the year. With the capacity discipline that we are seeing, I think it is a continuous process, but I am confident that the industry and us are going to do the right things to make it happen.

Alex Malfitani – Azul's CFO

On the hedging side, I think your question makes a lot of sense because they do go together. The more pricing ability we have to pass through cost increases to fares, the less hedging we need to do. I do not think that any airline is going to tell you that they are able to predict whether oil prices are going to go up or down better than the market.

If they say that that is their competitive advantage, I would kind of run away from that because hedging is insurance. We expect insurance to cost us a little bit of money and we expect hedging to cost us the same in terms of the premium.

Therefore, we always monitor our ability to pass through cost increases to fares together with our hedge position. Now that we see demand continuing to be strong and we see a seasonally strong quarter coming in, we do not need to be hedged as much.

We are around 15-16% right now. I think the whole industry is somewhat light on hedges, and I think that makes a lot of sense. We want to hedge the inventory that we have already sold. We cannot do anything about that inventory but, in terms of the future inventory, we are very confident in our ability to continue expanding margins to try to get back at least to the 2019 levels.

Yes, it is true that fuel prices went down significantly year-over-year, but they did go up from 2Q23 and they are still much higher than they were in 2019. I think it is important to remember that they are still much higher than in 2019.

Guilherme Mendes – J.P. Morgan

Super clear. Thank you. Have a great day.

Operator

Going on to the next question, it will come from Neil Glynn, sell-side analyst, Air Control Tower. Niel, we will open your microphone so that you may ask your question. You can proceed.

Neil Glynn – Air Control Tower

Hi. Thank you for taking the questions.

If I could ask two, please, both with respect to the recent negotiations and capital optimization. The first one, on currency really, back at the end of 1Q23, you were hoping for R$2.9 billion of lease payments in 2024 and I know that the reais has, obviously, strengthened against the dollar since this time.

So, I am just interested as to whether the updated payments fully reflect recent recovery of the real against the dollar, and if you could give us some feel for your exposure to potential further real recovery on the dollar for these lease payments.

And then the second question. Security deposits and maintenance reserves are obviously a large part of your balance sheet at about US$2.6 billion in June. Should the lessor negotiations that are not resolved impact this part of the balance sheet and should that have any ramifications for cash flows over the course of the next few months?

Thank you.

Alex Malfitani – Azul's CFO

Thank you, Neil.

The lease payments that we provided on the presentation do reflect an exchange rate of R$4.82, which is the exchange rate at the end of 2Q23. So, they are all dollar denominated and they do fluctuate with the exchange rate. So, if the R$4.82 is roughly where the exchange rate is today, if you see further strengthening of the real, those numbers can come down.

If you compare those numbers to the communication that we sent out last quarter, which also had the breakdown of the 2023 and 2024 lease payments, the changes that you see there are mainly from FX, but also from additional aircraft that we took delivery in that time frame. So those numbers should be the latest information with the latest FX.

And then, in terms of security deposit and maintenance reserves, yes, those were part of the negotiations with the lessors as well. There is a change there, and normally you would see that balance increasing over time as we increase the size of the fleet and also as the fleet ages. Right now, you should see them staying stable and then, as we execute on maintenance events or return aircraft, those maintenance balances will go down.

It will take a few years for those maintenance balances to go down, but they will happen because we negotiated that we would not add to the balance of the maintenance reserves, and then we would drop on those maintenance reserves as the maintenance events were delivered and the aircraft were returned.

John Rodgerson – Azul's CEO

I think that is one big thing. The big difference that is not reflected in the market is that not only did we do market-to-market on the leases, not only did we deal with the COVID related deferrals, but we also dealt with security deposits and maintenance reserves on a going forward basis as well. So that is not a P&L impact, but it is certainly a cash impact over the next five years.

As we became a much better credit profile for the lessors, they understand that that is good for us. There is a significant reduction going forward in those payments and that is an additional benefit to our cash flow over the coming years.

Operator

Moving on to the next question, it will come from Lucas Barbosa, side analyst, Santander. Lucas, we are going to open your microphone so that you may ask your question. Please, proceed.

Lucas Barbosa – Santander:

Essentially, I would like to know more on the CAPEX line related to aircraft, maintenance and checks. it was around 140 million in 2Q23. In 1Q23, it was much lower, and in 2Q22, it was lower as well. Was there any concentration of maintenance in 2Q23? What should these levels be in the coming quarters?

Alex Malfitani – Azul's CFO

Yes, I think 1Q23 was particularly low because we were preserving cash and we knew that we were going to have negotiations with lessors and OEMs. We are going to have new commercial terms with both of those groups of stakeholders.

So I think it was more than that, 1Q23 was low and I think 2Q23 is still low. Like I said, I think you should project in total CAPEX, which includes this line something between R$1.8 billion to R$2 billion on a go-forward basis.

Operator

OK. So, this closes our Q&A session. We will now move on to John for the closing remarks.

John Rodgerson – Azul's CEO

Thank you, everybody. We appreciate your time today on the call. Alex, myself and Thais will be on the road meeting with many of you in the upcoming months to kind of further update you on the story. We are excited about where we are, seasonally strongest part of the year ahead of us and full dedication to this management team to continue to build the greatest airline in the world.

Thank you, everybody.

Operator

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