Conference Call
4Q22 Earnings Results
March 6, 2023

Operator

Hello, everyone, and welcome all to the Fourth Quarter Earnings Call from Azul. My name is Zach and I'll be your operator for today. This event is being recorded (Operator Instructions).

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 fourth quarter earnings Call. The results that we announced this morning, the audio of this call and the slides that we'll reference are available on our IR website. Presenting today will be David Neeleman, Azul's Founder and Chairman; 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, and welcome everyone and thanks for joining us for our fourth quarter call. As you can see on slide 3, there is a lot to talk about today. I know you all want to hear the details about our comprehensive go-forward plan. John, Alex and their teams have worked very hard over the past 45 days to successfully reach commercial agreements for more than 90% of our Aircraft leases. These agreements fundamentally changed the financial future of our company. I would like to personally thank our management team and our partners who have shown a tremendous amount of confidence in our business and for good reasons. As you can see in the presentation, we have created the company creating billions in cash flow annually.

First, let me tell you about our great business and then John and Alex will share with you the details of our plan. Moving to Slide 4, 2022 was a record for Azul, we generated BRL16 billion in revenue, up 40% compared to 2019. Unit revenue was also a record at 40.29 cents up 26% from the full year 2019. Revenue performance due to our structural competitive advantages and our network combined with the strong growth of our business units made this possible, our wholly-owned and unencumbered business units also had record results this year compared to 2019, our loyalty program TudoAzul almost double its gross billing. Azul Cargo, our logistics business grew impressive 153% in revenue and ended the year as Brazil's largest domestic air logistics provider. Finally, our travel business Azul Viagens grew BRL1.3 billion in gross bookings.

Looking at 2023, we are excited at the opportunities we see. Later this month, we will begin flying our expanded network from Sao Paulo's downtown airport Congonhas, more than double to 84 daily flights which will serve all the largest corporate markets. We cannot wait to show these new customers, all that Azul still has to offer. Overall, for the year, we expect BRL20 billion in total revenue and EBITDA above BRL5 billion, that's more than a 40% increase from 2019.

Moving to Slide 5, we show making strong development of our route network and unrelenting focus building and expanding our competitive advantage. We serve a 158 destinations and Azul is the only carrier in 80% of our routes and the market leader in more than 90% of them. In addition to our domestic network, our international capacity will fully recover this year. We recently announced exciting new destinations such as Paris and Curacao. Together with Miami/Fort-Lauderdale, Orlando, Lisbon and Montevideo, we are putting together a very relevant international network. In addition, our codeshare partnerships with United, JetBlue, TAP and Air Europa will allow us to connect customers all over the US and Europe – significantly increasing our position in these markets.

Finally, turning to Slide 6, I am very happy to say that 2022 was another exceptional operating year in which we followed up with the world's best airline award with the world with the world's most on time airline award. Just last week, we celebrated this achievement in our hanger and with our members and there was not a dry eye in the house. I think I even spot on shedding a few tears. I'm just so proud of this team. As John will explain, we have an amazing business which generates billions of reals in cash flow from operations. We have built something very special and I am so excited about what is ahead of us.

With that, I'll pass the word to John to give you more details on our fourth quarter results and our go-forward plan. John?

John Rodgerson – Azul's CEO

Thanks David. Yeah, I did get emotional last week, it was very special, and I cannot thank enough our crew members who repeatedly shown their dedication for Azul. Without their passion and support, these results would simply not be possible. I would like to remind everyone that we had more than 11,000 of our people took unpaid leave of absence to help Azul during the pandemic. When they came back, they came back stronger and more dedicated and that dedication led us to be the most on time airlines in the world.

As you can see on Slide 7, revenue for the fourth quarter was another all-time record at BRL4.5 billion, 37% above 4Q 2019. Yield also an all-time record was BRL50.06 cents, an increase of 16% compared to 4Q21 and 32% versus 4Q 2019. We also had a record RASK compared to 4Q19, our RASK was up 27%. Operating income was BRL525 million in the quarter at an operating margin of 12%, our EBITDA margin was 25% with an absolute value of BRL1.1 billion. This is even more impressive when you consider that fuel was up 116% versus fourth quarter 2019 and the currency devalued 30%.

On Slide 8, you can see the sequential improvement in our RASK. First, you can see how significant and sustained the RASK improvement has been since 2019 and then how it improved through the year 2022. This is a clear signal of not just pent up demand but a new level of sustained revenue performance. Second, you can see that for 2023, our assumptions are not aggressive. I know Abhi and his team will always try to maximize RASK, but this chart shows that for 2023, we're just assuming what we've already achieved in 2022.

Azul has one of the highest EBITDA margins among its peers as you can see on Slide 9. The strength in the revenue performance, the improvements in the fuel environment and the milestones such as our Congonhas growth give you a clear indication as to the earnings strength of our airline and why we're so excited for this year and beyond.

On Slide 10, we bridge our 4Q19 results to 4Q22, you can see the negative impact from fuel, currency and inflation, how we were able to offset those cost increase through our growth, revenue performance, business units and being a more efficient airline exiting the crisis. With these initiatives, we were able to offset over 90% of the cost impact during the quarter alone, an impressive achievement given how fast and how much fuel prices increased during the year.

Even more impressive is our strong cash contribution from operations. Slide 11 shows that in 2022, we had a cash contribution of BRL5.5 billion when comparing the cash inflows to the outflows from operation. We paid over BRL5.1 billion in rent and debt, these are significant payments that supported our deleveraging process. As a result, we ended the year with leverage below 6, consistent with the guidance we gave you at the start of the year.

On Slides 12 and 13, we want to highlight further the magnitude of these aircraft, rent and debt payments and how they have grown since 2019. On Slide 12, you can see that in 2022, we paid over BRL3.6 billion in aircraft rent, BRL1.6 billion more than 2019, mainly due to the devaluation of the Brazilian real, COVID rent deferrals and our fleet growth.

Debt interest payments also increased in 2022, as you can see on Slide 13. In 2022, Azul paid over BRL1.5 billion in principal, debt and interest, BRL1.1 billion more than 2019 mainly due to the debt that we had to take on during the pandemic. As a reminder, unlike subsidized airlines in the U.S. and Europe, we did not receive any government financial help during that challenging time. But with the strong results from our operations, we've been able to significantly accelerate our deleveraging process. These levels of aircraft rent and debt payments are clearly challenging, and this is why we're so focused on optimizing these so that we can strengthen our balance sheet and improve our cash flow going forward. As David mentioned at the opening we have already made significant progress on that front.

Moving forward to Slide 14, you can see our yearly results since we launched and where the pandemic, currency devaluation and high fuel prices have impacted our results. As mentioned before for 2023, we expect a full and strong EBITDA recovery of over BRL5 billion, that's more than BRL1 billion of EBITDA, the strength of our business is evident.

On Slide 15, you can see that from 2017 to 2019, Azul consistently traded at about 8 times EBITDA, while we currently are trading at 4 times. It's incredible to think that just going back to a 5 multiple, which would still be well below our historical average, our valuation would need to triple.

Moving to Slide 16, we show what we believe is the main reason that our valuation is held back. As I showed you on Azul Day, here you can see the net effect of the combination of higher cash outflows, recovering EBITDA and the lack of government financial support during the pandemic. We have continued to address these challenges through revenue and productivity initiatives, together with the valuable support of our partners, we made significant progress since 2020 and we've had previously projected a cash gap of BRL3 billion for 2023. Now, thanks to the progress we have made, not only have we already eliminated that gap but our comprehensive go-forward plan results in significantly cash flow and balance sheet improvements for the foreseeable future.

Let me now turn it over to Alex so he can give you more details on this plan.

Alex Malfitani – Azul's CFO

Thanks John. I'm really excited to share with you the details of what we have been working on starting with Slide 17. As you can see here, we have developed and started to implement a comprehensive plan that provides a permanent solution to our capital structure, significantly improved our cash flow and provides maximum value generation for our stakeholders by ensuring that they receive 100% of what was committed to them.

We started implementing this plan by negotiating with our lessors, and on Slide 18, you can see why? About 80% of our gross debt is related to aircraft leases, therefore, addressing this debt in a comprehensive way results in significant cash flow improvements.

On Slide 19, you can see the progress we have already made over the last 45 days. As we announced in our material fact last night, we've already reached commercial agreements with lessors, representing more than 90% of our lease obligations and I am confident we will reach an agreement with the remaining share. We have seen strong support from our partners as they understand that this is a smart business decision, it maximizes the return on investment, and I want to thank them for their support and confidence. Throughout this negotiation, we've had zero aircraft withdrawals, in fact, our partners have delivered to us 12 additional new aircraft in the last few months, including four A320neos.

On Slide 20, we described these lessor agreements in more details. So under these agreements, subject to certain conditions and corporate approvals, lessors will reduce our lease payments to eliminate the COVID-related deferrals. They will also eliminate the gap between Azul's contractual lease rates and agreed upon market rates. In exchange, lessors will receive a tradable note maturing in 2030 and equity priced in a way to reflect our new capital structure, our improved cash flows and our reduced credit risk. Out of the total value that is being exchanged, which again is the reduction from both the COVID-related deferrals and the rent gap, the long-term note represents 40% while the equity represents 60%. Consistent with our reputation and our track record, this plan is designed to give lessors a 100% of our committed payments through this combination of long-term debt and equity in a reset balance sheet.

Moving onto Slide 21, we have also engaged with our OEMs partners, another vital stakeholder group, so we can address our Capex requirements. With a similar comprehensive permanent plan, we are making tremendous progress with this group as well. Once again, we're committed to significantly improving the cash flow for the airline, at the same time, that we follow the principle of 100% recovery for our partners.

And on Slide 22, you can see the cumulative effect of this plan. In 2023 alone, we converted the cash gap of BRL3 billion that we talked about from a negative to breakeven. The main items that were reduced are eliminated, as I mentioned, are the monthly lease payments, the maintenance Capex and the COVID-related deferrals. Remember though, this plan does not cover just 2023, this is not a stop gap for one year only. The results of this plan go well beyond as you can see on Slide 22. This is truly a permanent solution that aligns the interests of all of our stakeholders and creates a balance sheet and cash flow generation that is consistent with our strong profitability.

Now let me turn it back over to John for the conclusion.

John Rodgerson – Azul's CEO

Thanks Alex. Now, you can see why we're so excited to share all of this with you today. On Slide 24, we start to look a little ahead, we have always talked about the incredible growth opportunities and margin contribution from our wholly-owned and unencumbered business units. TudoAzul, Azul Cargo and our packaging business, Azul Viagens. We recently had them appraised by an independent firm, and in total, these fast growing businesses are praised at more than USD5 billion or BRL25 billion. Our comprehensive solution and its corresponding reduction of our credit risk combined with our growth in EBITDA, cash generation and our valuable unencumbered assets gives us strong confidence that we can access the capital markets when needed to invest in our growth.

Finally on Slide 25, we have to show you why we're so excited for the future. Our business is doing incredibly well, Abhi will talk about the revenue. We're hitting record revenues and record EBITDA, our customers love to fly us and our crew members love to work here. Yes, COVID and macro effects have had a negative impact, which is why we presented today real progress towards a permanent and comprehensive plan to improve our cash flow, optimize our capital structure and continue to invest in our business. I realize we gave you a lot of information today, but just in the last 45 days, we've made incredible progress and there's much more to come.

With that David, Alex, Abhi and I will answer your questions. Thank you for your time.

Questions and Answers

Operator

So, let's go to the first question from Fernanda Recchia, sell-side analyst, BTG. Fernanda Recchia, we will open your audio so that you can ask your question. Please proceed.

Fernanda Recchia – BTG

Thank you. Can you hear me?

Alex Malfitani – Azul's CFO

Yes.

Fernanda Recchia – BTG

Great. So hi, John, Abhi, Alex. Thanks for taking my question and congrats on the deal with lessors you recently announced. Just two questions from our side, I was wondering if you guys could provide us additional color regarding the terms agreed with the lessors especially in terms of the equity portion of it. I was curious to see if you could provide us the strike price you agreed with them or if you could give somehow any color on the potential equity dilution from the deal?

And second question, if you could please update us regarding the discussion with United Airlines, is this something that it's behind or discussions are still ongoing? Thank you.

John Rodgerson – Azul's CEO

Yeah, let me start and Abhi and Alex can add color to the rest of the questions. First of all, obviously today's price does not reflect Azul's value, right. When you have a business that produces over USD1 billion of EBITDA and I think our partners recognize that, and so the strike price at which lessors will come in is higher than it is today but we're 90% done and we'll communicate when we're 100% done with our lessors, right. And so it's more reflective of a 7, 8 times multiple based on where we are and it will give full recovery to our partners and we're excited for them and excited for us and it'll minimize dilution to the company because it's not being done at today's prices which don't reflect Azul's true value.

Alex Malfitani – Azul's CFO

Yeah, and just to add to that, I think the main objective here that we had on this call today, if you trace back to Azul Day, we talked about the BRL3 billion cash gap, we talked about how it was the smallest cash gap since the pandemic happened, we said that, well, obviously the preferred alternative would be to access the capital markets to finance that cash gap, but if that weren't possible, we knew we could count on the support of our stakeholders, and we even provided some information that we were getting a lot of support from our stakeholders that in spite of us being very public about the cash challenges that we were facing, lessors were delivering new aircraft to us and we were seeing a narrative in the market that lessors, you know it made sense for lessors to support airlines in 2020 but it didn't make sense to support in 2023, which obviously we disagreed, and today, I think the main message that we wanted to communicate to the market is that that support has materialized, right. And it's not because the lessors are nice or because they like us, I think they are nice and I think they like us, but that's not right, it's a good business decision and they know that a company that produces more than USD1 billion in EBITDA a year is not fairly priced at these levels, right. And so, we will provide additional color over time, we will provide additional details, but as John said, we want to be fully finalized with our negotiations with lessors, and over time, we will provide that information.

John Rodgerson – Azul's CEO

We entered COVID as one of the most profitable airlines in the world and we will end 2023 as one of the most profitable airlines in the world. COVID wasn't our fault, the devaluation of the currency wasn't our fault, but we've done enormous things to combat those challenges, including having our people go on unpaid leave of absence. And so I think the market and our partners give us a lot of credit for what we've done and they want to invest in Azul going forward because they know it's a good business decision.

Well, I'll let Abhi talk through the relationship with the United.

Abhi Shah – Azul's President

Yeah, Fernanda, about United, we have a great commercial partnership with them as we do with JetBlue, with TAP, Air Europa and others as well. We continue that commercial partnership with connectivity in Brazil and in the U.S. We're always looking at opportunities but there's nothing in the short-term more than a commercial partnership to announce.

Fernanda Recchia – BTG

Perfect, guys. Thank you very much.

Operator

The next question comes from Bruno Amorim, sell-side analyst from GS. Bruno, we will open your audio so that you can ask your question, please proceed.

Bruno Amorim – Goldman Sachs

Hi, good morning, everybody. So, my question is on the unit revenue assumption for the year, as you laid out your assumption seems to be conservative indeed. What can you comment in terms of this flattish RASK going forward in light of falling jet fuel prices, have you been feeling the pressure from the market to lower unit revenues or since everybody, Azul included, needing to see higher margins going forward means that even under lower jet fuel prices, the pressure is now there. Can you comment on the dynamic please?

Abhi Shah – Azul's President

Yeah, hi Bruno, Abhi here. Sure, a couple of things, overall, I think the industry is very disciplined and I think the industry is going to be very disciplined. We certainly are doing our part and if you look at the fourth quarter of last year, we were actually down 3% in capacity domestic and that was because of fuel prices and the adjustments we made to our network. Looking ahead, this year, we're going to grow about 15% total, but only about 6% to 8% domestic and so we're not seeing the volume pressure, or the load factor pressure that would cause us to sacrifice the hard work that the industry has done in increasing average fares. I think the industry did a really good job when the war started last year, and I think that overall, we want to keep those gains. The customer is used to these new prices, customers are not asking for lower prices, and in fact, as we talk today, we're just coming off the last seven days, as John referenced, record booking revenues. And so, we're seeing good momentum on the booking side, our intention certainly is to be very disciplined on the average fare side, not give back the gains regardless if fuel goes down or not. And I think the industry overall wants to recover the profitability in the best way possible.

Bruno Amorim – Goldman Sachs

Thank you. And then if I may just a quick follow-up, so your guidance implies an EBITDA margin of at least 25%, right, BRL5 billion EBITDA, BRL20 billion revenues, should we think about the target as around 30%, which was the pre-pandemic level, is that the level that you are targeting for the next couple of years or are you thinking differently?

John Rodgerson – Azul's CEO

Yeah, Bruno, there's no reason why Azul shouldn't get back to those levels, right. And so we showed you what we did in the fourth quarter at a 25% EBITDA margin, we're going into 2023 with lower fuel prices, a strong revenue environment, and so there is no reason why this business shouldn't be there. So if we don't get there, it'll be a big disappointment and we're not saying that we're going to get there in 2023, but obviously that's our target going forward, and we're going to continue to go after it.

Bruno Amorim – Goldman Sachs

Perfect. Thank you so much and congratulations.

John Rodgerson – Azul's CEO

Thank you.

Alex Malfitani – Azul's CFO

Thank you Bruno.

Operator

The next question now comes from Gabriel Rezende, sell-side analysts from Itaú BBA. We will open your audio so that you can ask your question Gabriel, please proceed.

Gabriel Rezende – Itaú BBA

Thanks. Hello, everyone. Thanks for giving the space to make the questions. Two on our side as well, one regarding your announcement regarding the negotiations with lessors. So just trying to confirm here that debt 2030, it would not be comfortable, right? So just confirming that. And also, just try to get a color on what the cash outflows regarding these debt should be in the coming years until it is paid fully in 2030? And also on the operational front, I was just trying to get your color, your view on what your expectations are for the room you have to recover things back to pre-pandemic levels regarding your passengers, so for example, corporate customers, they're still not back to pre-COVID '19 levels, just like to understand what is the additional room that you have to expand on those clients and what is already incorporating in your guidance for BRL5 billion EBITDA in 2023 as well?

Alex Malfitani – Azul's CFO

Hi, Gabriel, thanks for the questions. Alex here. Correct 2030 note is not convertible. In terms of cash outflow, outflows in coming years, which is additional detail that we are looking forward to providing to you over time once we conclude all of these negotiations, and like we said this plan is a comprehensive plan that involves more than what we've done so far. But I think the main message is the negative BRL3 billion that we have for 2023, it's going breakeven and we had talked about a breakeven for 2024, which is now going to be positive and should be positive every year after that item and we look forward to providing you with additional details over time.

Abhi Shah – Azul's President

Hey, Gabriel, about the opportunities, I can just think three quick ones. So corporate, you are correct. We are seeing about 85% corporate volume recovery; revenue is above 100% because the average fares are 50% higher. So we are over 100% in revenue but still corporate volumes are 85% and we expect that recovery to continue. Another great opportunity we have is our utilization, you will notice our utilization is still below our pre-pandemic levels and that's for a couple of reasons, one is higher fuel, as you have higher fuel, you tend to reduce your flights that are, at the end of the day, early at the day or nights and weekends as fuel is coming down and stabilize at these levels, we are seeing opportunities to increase utilization which is obviously a very, very positive for EBITDA.

International, at the end of last year, we were still only about 85% to 88% recovered in terms of our international network, and by the end of this year, we will be a 100% recovered in our international network, so that's future opportunity as well. So overall, we are seeing great momentum with the industry, with discipline, with demand, and there's still some significant upside to come.

John Rodgerson – Azul's CEO

I just want to highlight a couple of things, we just remove the masks last week and so you think about where is the demand potential going, and Brazil we just over Carnival mask finally came off last week. And so I think there's a lot of runway, unemployment in Brazil is at a multiyear low, we're seeing good economic activity overall. And so I think we feel good about the macroenvironment here the first time in quite a few years.

Gabriel Rezende – Itaú BBA

That's very clear guys. Thank you.

Operator

Okay, thank you. The next question now comes from Stephen Trent, sell-side analyst from Citi. Stephen, we're going to open your audio so that you can ask your question, please proceed.

Stephen Trent – Citi

Great. Good morning, everybody, and thank you very much for taking my question. I was curious, I would just on a long-term basis, love to get your view on a high level basis on how you might be thinking about long-term consolidation in Brazil, not only the back of the solid results this morning but of this great deal that you've reached with the lessors? Thank you.

John Rodgerson – Azul's CEO

Steve, I always think it's a possibility, that's something that we've talked about, but this is about focusing on Azul, and I think that's what we're very excited about. And so when you look at our BRL20 billion of revenue this year, the EBITDA performance, the cash gap flows and the cash flows going into 2024 and beyond that assumes no cooperation consolidation anything along those lines. We'll study it, if there's an opportunity there, but you know what, we believe so much in the core business that we've built, we've got 13,500 passionate crew members that are delivering on a daily basis to deliver an unbelievably great experience. And as I said earlier, one of the most profitable airlines in the world, we just had an overhang because of COVID and the devaluation of our currency and we've addressed that and we've addressed that in a big way, and as Alex said, it's not a stop gap, it's not a band-aid, we've addressed it once and for all and we're ready to move forward.

Stephen Trent – Citi

Really appreciate that John. And if I could just follow-up really quickly on one item, I spent most of the last two months hearing from your U.S. based counterparts about challenges trying to find pilots, how are you guys seeing it down there in terms of your pilot supply? Thank you.

Abhi Shah – Azul's President

Hey, Steve. Brazil has a really rich history of aviation, and so we have a great pipeline of flight schools that we partner with. We actually use even our caravan operation as a mini flight school inside of Azul to prepare our pilots to enter into our fleet. So we're not seeing any constraints when it comes to pilots or even staffing overall. And we're actually more efficient right now, and so in terms of our overall staffing, but no limitations in terms of pilot hiring.

Stephen Trent – Citi

Okay, very clear. Thanks, Abhi, I'll leave it there.

John Rodgerson – Azul's CEO

Thanks Stephen.

Operator

Okay, thank you. The next question comes from Stefan Styk, sell-side analyst, Bank of America. Stefan, we're going to open your audio so that you can ask your question, please proceed.

Stefan Styk – Bank of America

Hi, this is Stefan Styk with Bank of America. Thanks for taking my questions today. I wanted to ask on the new 2030 notes, will these be secured or unsecured and can you provide any other details on the terms like size, interest rate, potential call, schedule and things like that? And then my other question is on the capital plans slide, it seems to imply that there is something coming up with bondholders and potentially a new money component as well. Can you expand on what options you're seeing here as well as your potential planning? Thank you.

Alex Malfitani – Azul's CFO

Thanks Stefan, the 2030 notes are unsecured will like we talked about, we are very excited to share more details. And as we normally do, right, I think you know us for our transparency, we just want to be really finalized with all of our lessors before we do that, but we will provide that information in due time. Obviously, I think similarly to the valuation that we're talking about to the equity, the coupon and debt, the cost of debt on this instrument is nowhere near the levels that you're seeing on the screen because again they do not reflect the health of the restructured company. The interest that we will pay will be reflective of the improved cash generation, the stronger balance sheet and the reduced credit risk, and like I said, we'll provide that as soon as we can.

John Rodgerson – Azul's CEO

Yeah, as it looks towards our 2024 bonds or 2026 bonds, I think that that's a conversation we plan to have and we'll have that with the bondholders, right. And I think that you can see how we treat our stakeholders and the bondholders are part of our stakeholder group. But as you look to new money and the unencumbered assets that we have, no one wants to bring in new capital to Azul to pay for COVID deferrals, right. And so the new capital that comes into Azul is to fund our growth going forward, strengthen the balance sheet, have us continue to take E2s and A320neos, and that's the intention. And so you really can't go to the capital markets using Tudo Azul or other unencumbered assets that you have to raise new capital just to pay back old stuff, right. And so this is a true reset, this is a true fix, a permanent fix of the balance sheet that works for our crew members, that works for our lessors, that works for our bondholders, works for everybody. And so, yeah, that is the idea. And I think the fact that we got through 2020 and 2021 with BRL5 billion of unencumbered assets, I think the potential is limitless for what we have to do going forward.

Stefan Styk – Bank of America

Thank you.

Operator

Okay, thank you. The next question now comes from Daniel McKenzie, sell-side analyst from Seaport Global. Daniel, we're going to open your audio so that you can ask your question, please proceed.

John Rodgerson – Azul's CEO

Maybe on mute Dan.

Alex Malfitani – Azul's CFO

So, we'll move onto the next one and if Dan can try again.

Daniel McKenzie – Seaport

Yeah, can you hear me okay?

John Rodgerson – Azul's CEO

I hear you, Dan.

Daniel McKenzie – Seaport

Yeah, I'm so sorry about that. Couple of questions here, one is just on the pace of potential pre-tax earnings recovery. So just a question for Abhi here, revenue strong, growth looks like it's going to be double-digits into the weakest quarters of the year. So the question is, can Azul reach a quarterly pretax profit in any of the quarters this year?

Abhi Shah – Azul's President

Yeah. So I think the main key there Dan, as you know, the main volatility that comes on the net income line comes from FX, right. So I think assuming stable FX or even some tailwinds coming from that. Yes, that is a possibility, we don't give guidance on a net income basis. I think all of you that have modeled us for the last few years, that's probably the hardest line to model. But in terms of business fundamentals, strength of demand, unit costs, unit revenue, size and especially with the restructured balance sheet, right, because the operation is strong, generates a lot of profit, a lot of cash and now with a balance sheet and interest expense that fits within the company and is consistent with the profitability of the company, that's certainly a possibility depending on what happens with the exchange rate.

Daniel McKenzie – Seaport

Yeah, that's exactly my question with the restructured debt, reduced interest expense, it would seem like it'd be a lower hurdle for you guys to get there. And then is the plan to encumber or was TudoAzul or the Cargo business encumbered, it doesn't look like it was, and I guess if it was not, what was the thought process around not encumbering those because at least outside looking in, it seems like it might have been an opportunity to lower the cost of borrowing, but if you can just elaborate a little bit more on how you approach the restructuring?

John Rodgerson – Azul's CEO

Yeah so, Dan, when we look, we were able to borrow unsecured in 2021 at 7.38, right. And so, the market was opened to us at that time, I think it's a blessing that we got through the pandemic without encumbering our assets, right. And so I think that now we're going to play from a position of strength, we fix the balance sheet with the lessors, which again, as Alex showed is 80% of the problem, and so the fact that we have the security associated with our Cargo business, associated with TudoAzul, I think that provides the opportunity as we move forward, right, and we want to make sure that we use that for the best interest of Azul's long-term plan, not just a band-aid during COVID. And so now, we have an opportunity to do something with those assets.

Alex Malfitani – Azul's CFO

Yeah, exactly, that's how we see it, right. Having those unencumbered assets is a good thing. And look, when the markets were open, there was no need to encumber the assets, we could accept a reasonable cost of debt without encumbering the assets and save those for a rainy day. When the bond is trading at the levels that we were seeing over the last few weeks, that did not really reflect the fundamentals of the business or the strength of the support that we knew we could count on, it didn't make sense for us to issue any kind of security, even if it was collateralized because it would be anchored on these rates, right, and there is a logic here for the sequencing because once everybody realizes that there is no risk to this company, that the company was going to continue producing above average or industry leading profits and growing we should see a cost of equity and a cost of debt, that is more in line with the company. And then providing some color on additional collateral to reduce that cost of debt even further, that's the right time to utilize the asset.

Daniel McKenzie – Seaport

Understood, thanks for the time you guys.

John Rodgerson – Azul's CEO

Thanks Dan.

Operator

Okay, thank you. The next question comes from Victor Mizusaki, sell-side analyst from Bradesco BBI. Victor we will open your audio so that you can ask your question, please proceed.

Victor Mizusaki – Bradesco BBI

Congrats for the restructure and the 4Q22 results. We have two questions here, the first one according to our numbers, Latam had a kind of aggressive capacity expansion plan for the second quarter. So how do you expect Latam to react as Azul and Gol restructuring the balance sheet, so do you expect Latam to pullbacks some capacity and then we're talking about, let's say, we're talking about the low season, we're talking about higher yields and higher margins?

And the second question is regarding to the Slide number 21, where you mentioned about the OEMs and Capex. So my question here is we're talking about a permanent reduction and if it is only for 2023 and this is a permanent reduction then can we say that maybe you were also change maybe the fleet planning ? If you think about the deliveries and maybe you could get additional discounts?

Abhi Shah – Azul's President

Yeah. Hi, Victor, regarding industry capacity, obviously, I cannot speak to Latam directly, but we've looked at the guidance that they've put out, Gol has also put out capacity guidance. And overall, we think the industry domestically is going to grow about 8% to 10% this year versus 2019. So, I actually don't think that that's bad to be honest with you, I think it's pretty disciplined overall. I think we're going to be about 6% to 8% domestically, the industry overall about 8% to 10%. And so, I think everybody has been pretty disciplined. I think all the airlines want to recover the profitability that we lost over the last couple of years, I think, as I've said before, the customer is willing to pay the prices that are out there, we're not seeing drops in demand and we, in fact, we think demand is stronger than ever, and I think airlines will adjust based on the load factors and the demand that they're seeing. So, looking at overall industry capacity, I think it's going to be about 8% to 10% above 2019 levels, which I think is pretty decent overall given the level of demand that we're seeing.

John Rodgerson – Azul's CEO

Victor, I just want to highlight another thing, too, I just want to remind everybody that our capacity, 75% of it now and 80% of it going forward is on next-gen aircraft, A320neos and E2s, right. And so, I think that's an important distinction. And the other thing that you highlighted, Azul is not going anywhere, Gol is not going anywhere, Latam is not going anywhere, right. And so, it makes sense for us to all act rationally in the market and price according to the cost structure that exists in Brazil today and I think that's the big message, right. And so again, we have more ASKs on next-gen aircraft by a wide margin compared to our competitors, all right. So, when you talk about the cost structure in Brazil, we have the lowest cost in Brazil, flying A320neos. We have the lowest cost in Brazil flying E2s, and so I think we're very well positioned and I think the market will be very disciplined. In the exit financing of our competitors is high cost of capital, right and everybody needs to earn a return to pay for that cost of capital.

Alex Malfitani – Azul's CFO

Yeah, and on the OEMs Victor, very similar concept to the lessors, we started with the lessors, right, because the lessors as we mentioned represent almost 80% of our cash commitments and we started talking to the OEM's about two weeks after the lessors. So, the OEMs are maybe two weeks behind on the sequencing, and similarly to what we mentioned on the lessors, once we are done with the negotiations with the OEMs, we'll be happy to provide additional information. But the concept, you can already, rest assured that, it's the same 2030 note, same calculation for the dilution, so very similar concept and will provide that detail in due time.

John Rodgerson – Azul's CEO

Hey, Victor, one of the things to highlight is the OEMs are our partners, specifically Embraer here in Brazil as well as GE where we overhaul all of our engines in Brazil, had we decided to overhaul our engines outside of Brazil we'd have XM financing and so one of the big things that we're pushing jointly with our OEM partners is, if I'm going to overhaul engines in Brazil, I should get access to financing of that, right. And so that's something that we're working jointly with the new government on, we're working with our partners at GE and Embraer and I think that that's good for everybody. And so the OEM relationship is a little different than the lessors, right, it's a little bit more complex because of the different negotiations we have ongoing with Embraer and GE and Pratt & Whitney and Airbus and ATR, but they've been very constructive and very supportive, why because we have a fantastic business and they see that.

Victor Mizusaki – Bradesco BBI

Thank you.

John Rodgerson – Azul's CEO

Thanks Victor.

Operator

Okay. So, the next question comes now from Michael Linenberg, sell-side analyst, Deutsche Bank. Michael we will open your audio so that you can ask your question, please proceed.

Michael Linenberg – Deutsche Bank

Okay. Hey, can you guys hear me okay?

John Rodgerson – Azul's CEO

Yeah, we can hear you good from Deutsche Bank.

Michael Linenberg – Deutsche Bank

Hey, congrats on the news, obviously. Just a couple of questions here, as best as you can sort of give us on some of the numbers. Maybe, Alex, when we think about your interest expense this last year it was BRL4.6 billion and when I look forward at least with the charts that you've provided, does that as a result of these restructured deals, does that come down, like what's the appropriate interest expense that we should think about going forward?

Alex Malfitani – Azul's CFO

Yeah, absolutely. It comes down, Mike, if you remember the BRL4.6 billion number, right, it's a big number for those of us that long for the days before IFRS 16, that´s most of that number is rent, right, so if you're looking on a cash basis, right, the way we talk about our cash gap or our free cash flow, if you include the total rent payments that most of that interest comes from that rent payment is already included in that ramp payment. And since that rent payment is going to go down that interest expense should go down as well. There's going to be an additional, that we have a little bit of non-operating lease that that will remain, that interest should stay roughly the same. And then the 2030 note will have an interest component, right. We're happy to provide that detail once we have it, once we're all done with this part, but the net result should be a reduction in the interest expense.

Michael Linenberg – Deutsche Bank

Okay, so that's helpful. And then in the release, you do highlight or state that going forward we should see a measurable reduction in Capex in 2023 and beyond. And the way I think about it is this last year, you saw your lease liabilities go up by BRL1.8 billion, as I sort of tie that to Capex. Going forward, what is that number going to look like, rather than giving me a Capex number, what should we anticipate that lease liabilities would grow based on new airplanes coming in maybe '23, '24 rough numbers would be great?

Alex Malfitani – Azul's CFO

Yeah, that's an important question, Mike. As I always like to highlight that the Capex that we're talking about, does not include any new aircraft Capex because for the next couple of years, all of the aircraft that will be joining the fleet come from lessor orders. So, the Capex related to new aircraft. The whole Capex that you were seeing in our cash flow projections were for maintenance and they also had a big component of COVID deferrals, right, you know stakeholders, our OEMs also provided us with credit to get through the pandemic, they are providing us with additional credit, they are exchanging past dues for the equity and debt structure that we mentioned.

So, the big reduction will come from the elimination of the COVID deferrals and an additional reduction in the resulting or remaining maintenance Capex through additional credit from the OEMs. And then, as John mentioned, the credit lines that we are developing together, Azul and the OEMs to make sure that this big part of our financing need is finance, right, because other airlines in the world that maintain their engines, which is the majority of the Capex here, is engines on our E1 as they maintain their engines, they get financing and we've been paying cash for all of our maintenance events.

John Rodgerson – Azul's CEO

Mike, it makes no sense to have the Brazilian development bank financing subsidized U.S. carriers, right.

Michael Linenberg – Deutsche Bank

I hear you.

John Rodgerson – Azul's CEO

All we do for Brazil, the jobs we create, we buy the aircraft that's made here in Brazil. And so, I think that I think we've got a great case together with GE and Embraer to ensure that there is more financing lines available with the BNDS.

Michael Linenberg – Deutsche Bank

And John you're basically the only one, you are the only Brazilian airline buying Brazil. So just a few more because it obviously an important call. And again, I appreciate that you still haven't finalized everything, but again, I'm trying to get a sense of some of the impact here, if I look at your leases, on your balance sheet at year end, short-term, long-term, I get to a number about BRL14.5 billion, how much, like can you give me just a rough number like what percent is it half, is it 40%, that will tie to this 2030 note and the equity piece? Is it some portion or are you going to tell me all that is affected, I'm just I'm trying to get a feel for how much of the cap structure actually changes and there is a deleveraging moment hear too?

John Rodgerson – Azul's CEO

Hey, Mike, you would think about it in the following way. You need to take our COVID deferrals, right. and that's 60-40 split and then you need to take a look at all of our aircraft and say, hey, how much was Azul paying for an Embraer versus current market and that difference and so it varies right, in some aircraft, it's as much as 50% reduction in the rent and some its zero reduction in the rent. And so if you take a look at it and but the big component is the COVID deferrals and then we did the mark to market with the lessors but as Alex said, 90% where they are right now, the other 10% we're negotiating with and we believe we're going to get there. So of that debt that you're seeing on the balance sheet. All of it will be touched in some form, right, it doesn't mean that it goes away, but it will turn into 2030 note some of it in equity and some of it is going to remain where it is, but everybody's participating, everybody supporting the plan, and I think that's the most important message that we want to have today, and I know everybody is dying for more details and this is a phenomenal accomplishment that Alex and his team have done in a 45-day period, right. And so why are we aren´t 100% yet. Well, quite honestly, we're going to get there and we're probably going to get there over the next couple of weeks, right. And so this is I've never seen anybody restructure their balance sheet in the speed at which Azul's has done it and they've done it out of court and they've done it on amicable way why, because we have a fantastic business and we have great partners that believe in us.

Michael Linenberg – Deutsche Bank

Yeah, and then, well, John if I came back, I know in the public domain you have said at least as of the last count, I thought the deferrals at least pre-COVID was somewhere around BRL3 billion and then there's this mark-to-market piece, is that?

John Rodgerson – Azul's CEO

Yeah, that's. You got it.

Michael Linenberg – Deutsche Bank

Okay. So, then I can back in. Okay, the last piece and I feel like that this is the most important piece from a dilutive perspective, you showed up the chart, you said we're trading 4.2 times, if we were at 5, the stock will be a triple I think it's what you said, maybe if I heard you. And then you threw up a bunch of charts and talked about 7 to 8 times and you sort of talked about the long-term sort of where this company has traded. So, if I think about where ultimately the equity is struck, it's not going be struck at 4 times, I think you've been pretty clear about that and we know the high end and so it's somewhere in between, but it's clearly a lot higher from a multiple. Is that the right way to think about it?

John Rodgerson – Azul's CEO

You're hitting close, Mike. So let me, as we said earlier, we will give the details at the appropriate time and I think that's important, but it's something that's great for our partners, it minimizes our dilution, it's great for our equity holders. And so, I think that's the message today, right. We looked at all stakeholders, everybody wins and that is most important.

Alex Malfitani – Azul's CFO

Yeah and as we think about why, right, we talked about why we're trading at 4, it's either because the market doesn't believe our profitability or the market is seeing something different than us on a multiple basis, so it's not the profitability, right. We do think we're going to, well, our number is higher than consensus, but even if you just use consensus, which is around BRL5 billion, right, just adding one turn, which is BRL5 billion, you add that to the equity value that we had, not today but Friday, right, to make the math, and that's almost another 2x right, so if you take the 1x you're starting from, you had BRL5 billion on top of that, that's a 3x and then that's stopping at 5x which for a company that is one of the most profitable in the world, has cash flow generation, has lower leverage, why would we be trading at 5x when our average since we went public.

Michael Linenberg – Deutsche Bank

Yeah, no, I think the market seems to be agreeing to some extent with your stock up over 60% right now. So very good congratulations again, thanks for taking my questions, gentlemen.

Operator

Okay, thank you. The following question comes from Ygor de Araujo, sell-side analyst from Genial Investimentos. Ygor, we're going to open your audio so that you can ask your question, please proceed.

Ygor Bastos de Araujo – Genial Investimentos

Hi guys. Thank you for taking my question. Congratulations on the agreements with lessors. Just a quick follow-up on the previous question. Last year, you talked about a reduction of around 20% of the leasing costs from E1 to E2 aircraft, right. So, what I would like to understand is, do we continue with this assumption or does the new agreement change that level of cost reductions. I understand, I don't need the exact number, but it will probably be last in that right?

John Rodgerson – Azul's CEO

Yeah. So just highlighting what you talked about, there are several E1s that we're paying north of USD300,000 a month on, right, and this new agreement obviously reduces those to what the current market rate is, but the E2s were coming in at 20% below what we were paying. Obviously, the gap now changes as we've reset to market rates across the board, but we are as excited as ever about the E2s, the E2s and extremely profitable aircraft for us going forward. And so the ownership is lower than our historical average for E1s and it produces 18 more seats and on a cost per seat basis, this is down 25%.

Ygor Bastos de Araujo – Genial Investimentos

Yeah, it was very clear. Thank you. Thank you very much.

Alex Malfitani – Azul's CFO

Thank you.

John Rodgerson – Azul's CEO

Thank you.

Operator

Okay, so the following question now comes from Rogerio Araujo, sell-side analysts from Bank of America. Rogerio we are going to open your audio so that you can ask your question, please proceed.

Rogerio Araujo – Bank of America

Hi, gentlemen. Can you hear me well?

John Rodgerson – Azul's CEO

Yep.

Rogerio Araujo – Bank of America

Okay, great. Congratulations for today's announcements. So, I have actually a follow-up on this restructuring, I know you guys are going to provide more details when it's concluded, but only a direction on the expected impact on the balance sheet. So I understand, there may be a reduction of lease liabilities but also incremental debt instruments, so unexpected balance sheet gains on

that, also in terms of operating lease payments, I understand that the deferrals has not been paid so far. So, in terms of the level of payments that we see in current results and what is expected on the market-to-market on this repricing on rental rates going to market levels, if the direction is downwards and if it's going to be relevant somehow?
Lastly, if I may, the negotiations going on with the government in Brazil on taxes on jet fuel, is there any update here on timing and likelihood? Thank you very much.

Alex Malfitani – Azul's CFO

Sure. So let me start with the expected impact on the balance sheet. Let me talk about it directionally Rogerio. First, we see a lot of people using the balance sheet information, a lot of people using 7 times rent, and I think there is even a segment of investors that are taking the balance sheet and trying to calculate an average discount rate using an average discount rate to figure it out, right. So let me talk about sort of the balance sheet impact, if you are using IFRS 16 and then 7 times rent impact, so debt, net debt, gross debt or even leverage was not really the problem, right. The reason why the market has been so nervous and there has been such uncertainty and volatility on our paper was never a leverage and was never the level of debt that we have, right, we were able to issue debt at 7.38, like John mentioned, when our leverage was in the double digits and now that we are starting with a 5 heading to start with a 4, even before the restructuring, the market is a lot more nervous. So it's nervous because of the cash burn or the cash gap that we had in 2023 that we had projected for 2023 and not because of the debt, not because of the leverage.

Having said that, you should see a small reduction in net debt, if you're using IFRS 16 and you should, a lot of that depends on where our incremental cost of borrow will be by the time we finalize all this, because for those of you that maybe are not too familiar with IFRS 16, I have to use my incremental cost of borrow to calculate the present value of the leases. I don't have an option, right. And so, whatever that cost of borrowing is at the time when we renegotiated our leases originally during the beginning of the pandemic, it was in a 20%, right. And we'll see where it is once we are done here and that will determine a lot of what the present value on our balance sheet will be depending on what that number is. But we believe with our estimates on what makes sense, you should see a small reduction in net debt, if you're using our IFRS 16.

Now if you're using 7 times rent, you should see a significant reduction in leverage, right, because even if you were doing it right and you were not including the deferrals in your calculation, right, if you were taking the recurrent rent, you're taking sort of the total rent payments subtracting what was deferral related and leaving only the current rent and multiplying that by 7 times because the rents are going to be reset to market values, you should see a significant reduction in the lease liability, it's going to be 40% offset by 2030 note, but the net result should be a reduction in net debt.

Abhi Shah – Azul's President

Yeah, and regarding the fuel tax discussion, we've already assumed any potential changes in our EBITDA number for this year. So, it's already in our model and we're already planning for potential changes. So, it does not impact the BRL5 billion plus EBITDA guidance that we're giving today.

Alex Malfitani – Azul's CFO

But that's with what we know so far, right. The way we always talk about sort of government help, there's always a lot of talk, I think it makes sense for the government to stimulate travel in Brazil, this is a continental sized country where aviation can provide a lot of social benefits, can generate economic growth that can create jobs and potentially there is something that's coming, but we never include that potential upside in any of our guidance, in any of our planning, right, if it comes it will be additional upside. We're only including what is known and that we can count on in our guidance.

Rogerio Araujo – Bank of America

Fair enough. Very clear. Thanks very much.

John Rodgerson – Azul's CEO

Thank you, Rogerio.

Operator

Okay, that brings our Q&A session to a close. I would like now invite John Rodgerson for closing remarks. Please, John.

John Rodgerson – Azul's CEO

I'd like to thank everybody for joining the call today, and feel free to reach out to us, if you have any questions. We're really excited about what we were able to accomplish in such a short amount of time and there's a lot more work to be done. And so, we look forward to updating you in the market over the course of the next few months. Thanks everybody for joining us.

Operator

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