Conference Call

3Q22 Earnings Results

November 11, 2022

Operator

Hello everyone and welcome to Azul's Third Quarter Earnings Call. My name is Otavio, and I will be your operator for today. This event has been recorded and all participants will be in listen-only mode, until we conduct a Q&A session following the company's presentation. If you have a question, click on the Q&A icon at the bottom of your screen and write your name and company. When your name is announced, please turn your microphone on and proceed. (Operator Instructions).

I would like to turn the presentation over to Thais Haberli, Head of Investor Relations. Please, Ms.Haberli, you have the floor. Proceed, please.

Thais Haberli

Thank you, Otavio, and welcome all to Azul's third 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; and John Rodgerson, CEO; Alex Malfitani, our CFO; and Abhi Shah, the President of Azul, are also here for the Q&A session.

Before I turn the call over to David, I'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 constituent forward-looking statements. These statements are based on a range of assumptions that a 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 Neeleman – Azul's Founder and Chairman

Thanks, Thais. Welcome, everyone, and thanks for joining us to our third quarter earnings call. Once again, I would like to start by thanking our more than 13,000 Crewmembers. Thanks to them, Azul delivered another quarter of great results.

Our Crewmembers run an incredible operation and deliver exceptional customer service. Through their dedication and passion, we were the world's most on-time airline in March, July and August, and we're amongst the world's most on time airlines in the other months of 2022.

In addition, our Crewmember satisfaction metrics hit another record in October, and continue to lead the industry. ANAC recently reported that Azul has the highest customer satisfaction among all airlines operating in Brazil, foreign or domestic. We also had less than half of the customer complaints of any other competitor.

Our customers love to fly Azul, giving us incredibly high NPS scores, not only tops amongst all airlines, but other world class companies as well that are outside of our industry.

All of these, as we continue to grow our network and serve more destinations than ever. We are now flying to over 150 destinations, 40 more compared to 2019 and triple the destinations of any other carrier in Brazil.

I could not be more optimistic about our future growth, which has powered our competitive advantages such as our unique network and flexible fleet. At the same time, as you'll see on Slide 4, we are delivering that growth in an efficient and sustainable way that continues to develop economic opportunities for our Crewmember and our customers.

Whenever an Azul plane touches down in any of our 150-plus destinations that we serve, especially if it's in one of the 80 that we serve alone, we know that fundamentally we can improve the quality of life in that community with more access to jobs, education and healthcare. We recently celebrated the fact that we now have more than 4,300 Crewmember registered as volunteers, and they are doing incredible work to help their neighborhoods and communities.

In October, as we do every year, we conducted our Breast Cancer Awareness Campaign. This year, it was our largest ever impacting more than 7 million customers.

Furthermore, our commitment to sustainable growth is anchored by our fleet transformation plan. With fuel consumption per ASK down 8%, and carbon emissions per ASK down 9% over the last three years. Azul is good for Brazil and is doing good in Brazil. Moving to Slide 5. Our competitive advantages are not limited to our fleet or network.

Our business units, Azul Viagens, TudoAzul and Azul Cargo continue their compelling growth trajectories and are key contributors to our industry leading margins. My baby Azul Viagens, continues its outstanding performance, benefiting from the positive trend in leisure travel. It is on track to more than double bookings, compared to 2019.

TodoAzul ended Q3 with 15 million members and gross billings up 82% from Q3'19, and is also on track to generate over BRL 2 billion in gross billings this year. We are very excited about the increased relevance of this program. We'll have starting in 2023, when we more than double capacity in Congonhas airport, in downtown in Sao Paulo.

Our Logistics business, Azul Cargo, has doubled revenue, compared to the third quarter of '19, driven by a strong demand for our end-to-end logistics solution and our exclusive network with delivery times under 48 hours to over 2,500 cities in Brazil. I truly believe in our sustainable and profitable growth. We are creating the best experience for our Crewmembers and customers and contributing significantly to Brazil's development by providing opportunity, employment and promoting tourism all over Brazil.

As John will explain, we have a great business, which generates billions upon billions in cash flow from operations. I'm proud of what the team has built, and I'm even more excited about what is ahead, which lies ahead of us.

With that, I'll pass the word over to John to give you more details on the quarterly results. John?

John Rodgerson – Azul's CEO

Thanks, David. I would also like to express my gratitude to our Crewmember who once again delivered great results in the quarter. And I'm proud of the fact that in 2022 alone, we internally promoted more than 1,500 Crewmember, providing career growth and life changing opportunities for them and their families.

Moving forward, as you can see on Slide 6, we delivered another all-time record revenue of BRL4.4 billion in the quarter, up 44% versus the same period in 2019, while generating 6.5%

more capacity and had a load factor of 82% in the quarter.

In the third quarter, we delivered once again unit revenue around 40% higher than last year with a 20% growth in capacity. As you know, when capacity grows, unit revenue normally goes down. So the fact that we grew unit revenues 40% demonstrates the strong demand environment in our network and our capacity discipline. Also load factor in the quarter reached 82%, two percentage points higher year-over-year. We expect this strong demand to continue given the positive trends for economic activity in Brazil.

Brazilians are benefiting from more flexible work arrangements, allowing them to travel for leisure more often, just like in the United States. We ended September with 14 consecutive months of leisure demand above 2019 levels, showing this was clearly not pent-up demand. This is the strength of the Brazilian leisure market, which is complementing the continued recovery in corporate demand.

Corporate fares also reached new records at 150% of pre-pandemic levels, while traffic has only recovered 80%. EBITDA in the quarter reached BRL925 million, in line with third quarter 2019, even with a 138% increase in fuel prices, a 32% devaluation of our currency, and over 20% inflation in Brazil over the past three years. This clearly demonstrates the sustainable advantage and earnings power of our business model with our unique network, flexible fleet and low cost structure.

Moving to Slide 7. Our network advantages combined with strong demand for our services allowed us to raise fares by 43%, while stage length remained flat to 2019, a clear sign that we're allocating the capacity in the right markets at the right time.

As you know, our RASK and yield in dollars are also up versus 2019, shown on Slide 8. The strong demand trends allowed us to increase fares and to overcome cost pressures from fuel and currency devaluation to continue expanding margins and improve cash generation.

On Slide 9, you can clearly see the challenge presented by the steep increase in fuel prices. This is clearly our number one challenge today and one more reason for us to remain disciplined in our capacity deployment, and continue to take advantage of the strong demand environment at high yields.

Slide 10 shows how critical it is to be the leading operator in next-generation aircraft in the region, with 70% of our ASKs flown by next-generation aircraft. Given that fuel prices in Brazil are about $1 per gallon higher than the United States, flying a young, fuel-efficient fleet is crucial here. The fact that our fleet transformation is so far ahead, compared to our competitors is a clear competitive advantage.

In addition to making financial sense, it's also clearly a more sustainable way to grow with our fuel consumption PRASK, ASK, down 8% compared to third quarter 2019, and carbon emissions down an incredible 30% since 2016.

When we compare the EBITDA we generated in the third quarter for the same period in 2019, the impact of fuel and foreign exchange rate is more than BRL1.1 billion, as you can see on Slide 11. However, thanks to the strong demand environment, which we expect to continue given the positive trends of economic activity in Brazil, we're actually able to generate EBITDA in line with 2019.

Moving to Slide 12, you can clearly see the combination of capacity deployment, network design and revenue generation. We fly the most efficient aircraft over the shortest stage and charge the highest fares. We have clearly optimized our network and fleet for the current cost environment in stark contrast to our competitors, directly leading to our industry leading results. We have made significant process to accelerate our fleet transformation plan and have announced the exit of 12 E1s from our passenger fleet through the end of 2023, giving us an opportunity to advance the delivery of next generation aircraft and further expand our margins.

Once again, we have the highest fares, the shortest stage length on the most fuel-efficient airplanes. We are at least five years ahead of our competitors in fleet transformation.

On Slide 13, you could see that our immediate liquidity continues to be the strongest in the region, totaling BRL3.4 billion, BRL300 million higher, compared to the same period in 2019, reflecting our commitment to sustainable growth and building long-term value.

Cash inflows in the quarter surpassed our operating cash outflows by BRL1.4 billion, and we continued our deleveraging process with BRL1.4 billion in payments of current and deferred leases and repayments of debt.

Let me repeat that our cash inflow from operations on an annualized run rate generates over BRL5 billion or around $1 billion in cash from operations annually.

As you can see on Slide 14, we reduced our leverage in the quarter by more than 0.5 turn to 5.7, and 5.6 turns year-to-date, beating our guidance of finishing the year with a leverage below six, one quarter ahead of schedule. Our leverage is the lowest in the region even when using 7x rent.

Moving forward, we'll continue to delever our business. Throughout the pandemic, we have demonstrated our ability to access capital and are now in a better position than ever, exiting the crisis with operations generating billions and billions in cash, and still having access to a variety of valuable unencumbered assets.

Finally, moving to Slide 15, we are confident and optimistic in our business model and our sustainable competitive advantages. I would like to thank all of our stakeholders for their continued support and we're excited to take advantage of all the great opportunities we see ahead of us.

To finish, I would like to extend a special invitation for our Azul Day on December 7. This year, the location is a very special one, the Congonhas Airport in downtown Sao Paulo.

As we had mentioned before, we had expected to more than double our presence at the airport and I'm pleased to let you know that we have officially received 84 slots at the airport. We'll put our expanded network for sale within the next few weeks and look forward to talking more about this and all things Azul at our Investor Day on December 7.

With that, David, Alex, Abhi and I are here to answer any of your questions.

Questions And Answers

Operator

Ladies and gentlemen. Thank you. We will now begin the Q&A session. (Operator Instructions) Let's now go to our first question. Diego Serrano from Credit Suisse. Serrano, you have the floor. We'll now open the microphone for you. Go ahead, sir.

Diego Serrano – Credit Suisse

Hey everyone, thank you for the opportunity to ask questions. Just a couple from my side. First regarding yield, I was wondering what could we expect for yields in the upcoming quarters? I mean, could we assume they have peaked during this quarter, fuel prices may have started to normalize or could we expect the usual sequential increase from third to fourth quarter given the high seasonality? And also what could we expect going forward into 2023?

Abhi Shah – Azul's President

Hi Diego, Abhi here. We expect the trends to continue. The market and we are pricing to demand. Demand continues to be strong. Corporate demand in terms of revenue is over 100% in 2019. Leisure is strong. What we are seeing in Brazil is similar to what we're seeing in the U.S. as well. The U.S. Airlines, Scott Kirby, United talked about business and leisure combination. We're seeing that here as well. So no, our intention is to continue the yield progression, take advantage of seasonality, take advantage of demand and continue on this path. I believe the industry will do as well. And frankly, that's how we've achieved record unit revenues in September. I think November is going to be another record in terms of unit revenues, and we're much focused on the yields to make sure we maximize revenue.

Diego Serrano – Credit Suisse

Okay. Perfect. Thank you. And a second one if I may. I wanted to know about your capacity plans for 2023. I mean, I recall you mentioned low teen year-over-year growth would be reasonable for 2023, but that you had not yet disclosed plans as you expected potentially upside coming from the increasing market share at Congonhas, so in that sense do you have any early expectations?

Abhi Shah – Azul's President

Yes, Diego, I think that's mostly consistent with what we are planning around the low teens focusing on the domestic market, we have some international as well. As you mentioned, we have Congonhas coming in as well end of March, early April. You will see higher growth in the first quarter only because this year, we were impacted by Omicron in January, February. But it's basically our current network coming full year with conversions between E2s and E1s. So we will put more E2s into service. We will take out some E1s as part of our fleet transformation, but around low teens in terms of ASKs sounds about right.

John Rodgerson – Azul's CEO

And I think it's important to highlight that every E2 has 18 more seats than the E1s that are exiting. So not only are they much more fuel-efficient aircraft, they generate more revenue. And so departures are certainly not going up that much because it's an upgauging effect, which will help drive down our unit cost.

Diego Serrano

Okay. Perfect. Thank you. Very fair.

Operator

We now have a question from Michael Linenberg sell-side analysts with Deutsche Bank. Michael will open the phone for today, a microphone for you and you can ask your question. Go ahead sir.

Michael Linenberg – Deutsche Bank

Hey, can you guys hear me?

Abhi Shah – Azul's President

Yep, we can hear you Mike.

Michael Linenberg – Deutsche Bank

Okay, okay. I guess just two questions here. John, you talked about the 84 slots at Congonhas. Is that incremental to what you currently have or is that the total amount? And I guess we should think of those as one-way slots, right. So are you offering 42 flights, 42 round trips? I just want to get a sense of your size?

Abhi Shah – Azul's President

Yes. In terms of our current operation, Mike, we'll go from 20 departures a day to about 42 departures a day, so we were slightly more than double.

John Rodgerson – Azul's CEO

And Mike, I think it's important to highlight for investors. I think everybody watched the drama of us trying to buy Avianca Brasil, everything that was done to prevent us from buying that company. And it's actually been a blessing in disguise, right. We didn't end up buying it. We actually got more slots than Avianca Brasil had. So it's been a great thing. We didn't have to assume that debt. We didn't have to assume all of that liability. And so it actually ended up working out much better for Azul in the long run than had we acquired those slots via purchase of that airline.

Michael Linenberg – Deutsche Bank

Yes. No, absolutely. It's a good deal. And then just on to Alex. I know you have no significant debt repayments over the next couple of years, but I know that you start paying some of these lease deferrals. And as I recall, was it BRL0.5 billion per year? Can you just update us on what that number is? And I think it was over four years, maybe it was like a total of BRL2 billion, BRL2.5 billion as we think about modeling some of the cash flows for next year? Thank you.

John Rodgerson – Azul's CEO

Hey Mike, I'm going to jump in front of Alex, and pass it off to him, right. The key is to have a great business that generates an enormous amount of operating cash flows, right. You're talking about EBITDA number next year of BRL5 billion. And so we've got great partners and our stakeholders. And if you take a look at everything that's been thrown at Azul between the pandemic, nine months without revenue, and look at how we've managed this, right. And you think of our partners. And so do we have to payoff everything over a two, three-year period or is it more of a four, five-year period, right. And so I think we have a lot of flexibility with our partners going forward. But the most important thing is that we run a fantastic operation that generates cash and then we have a financeable business, but I'll let kind of Alex walk through the specific numbers.

Alex Malfitani – Azul's CFO

Yes, what's important, I think your recollection is right because there is sort of a second increase of deferrals in 2023, but we already had that effect in 2022, right. So you're not going to see an increase in cash outflow from rents between 2022 and 2023. The reason why that's happening is that in '22, we paid for the second wave deferrals. And in 2023, we're going to start paying for the first wave deferrals, right. So there is sort of a, I think you remember that in 2023, the deferrals are going to happen, but they already started in 2022.

So you're not going to see increased pressure from deferrals in terms of rent into 2023. Actually, we've been dealing for the last three years with negative free cash flow, if you assume no financing, right. If you look at EBITDA minus rent, minus CAPEX, minus interest, minus debt, that number has been negative in 2020. It has been negative in 2021. It was negative in 2022 and it will be slightly negative in 2023. But in fact in 2023, it will be the lowest gap since the beginning of the pandemic, right. That number has been shrinking every year.

So when you do sort of a cumulative calculation of everything that we had to deal with over the last three years plus the fourth year, we have dealt with 85% of the problem, right. So the cash gap in 2023 is the smallest that we've had so far. And as we've demonstrated over the last 30 months, we can access capital when and as needed, right. We'll get the right capital, at the right cost, at the right time. And as John said, the beauty is that we have a highly financial business because we have just a very profitable and cash generating operation, right. So we'll deal with it as necessary, but the good news is that the sort of the cash need for 2023 is the lowest out of all the four years that we've been dealing through this pandemic.

John Rodgerson – Azul's CEO

In the first six months of 2022 were not easy. We had the Omnicon and the war in Ukraine that drove up fuel prices. We shared that fuel prices more than doubled compared to 2019. But look at the performance on the revenue side, right. The revenue has now made up for that and we're delivering similar EBITDA that we had in 2019. And clearly, in 2023 we'll be well above 2019 levels. And so the financing will take care of itself as we run a great company and generate operating cash flow.

Michael Linenberg – Deutsche Bank

That's great. Yeah, thanks gentlemen.

John Rodgerson – Azul's CEO

Thanks Mike.

Operator

Okay. Then next question comes from Daniel McKenzie, sell-side analyst with Seaport Global. You have the floor Daniel. Go ahead and ask your question.

Daniel McKenzie – Seaport

Okay. Hi, can you hear me?

Alex Malfitani – Azul's CFO

Yes.

Daniel McKenzie – Seaport

Yeah. Hey, good morning guys, thanks. That's a great place to actually pick up, billions of reais and operating cash flow. As you look at the getting back to sustained profitability, it seems like the pieces are there. But how committed are you to making the tough capacity decisions if you need, and what is the thought process for when you're thinking that Azul can get back to sustained profitability?

Abhi Shah – Azul's President

Hey, Dan, Abhi here. I can start with the capacity part. So I think we have been very, very active in managing the capacity, given the demand environment and given the fuel environment. So if you look at our September traffic, we were actually down 2% in ASKs September '22 versus September '21. If you look sequentially now going forward between what our capacity is in November, October, November to what your summer peak season in January, we actually have the lowest sequential increase compared to the industry. And so if you look at our stage length, right, we have the lowest stage length, as John mentioned, and we have the highest corporate fares. So all of these with 70% of our ASKs with next-gen aircraft. And so we actually are very, very active in adjusting the network as needed. We actually could fly more if we wanted to, but we're making sure that we're flying what makes sense, and we're keeping the quality of the revenue, as you can see on the RASK side, very, very high, and that continues to be our focus. So capacity will come with fuel, capacity will come with demand, and we're managing just to get the best results overall.

John Rodgerson – Azul's CEO

Yeah, Dan, I just want to highlight a couple of other things, right. I mean you've seen us accelerate the fleet transformation and the retirement of the 12 E1s that were previously in our plan to operate all of 2023. And now they're exiting early, right, and then going into next-generation aircraft. So you take 12 aircraft, replace them with E2s, put Congonhas into your model, maybe the crack spread kind of gives a little bit of relief and you see the leverage that this company has going forward.

Daniel McKenzie – Seaport

Very good, thanks guys. And picking up on working capital priorities for the coming 12 months, thanks for the presentation, thanks for the prior comments. If you could just help us understand sort of the biggest uses, how funded aircraft being returned, are the long-term maintenance reserves enough to cover those requirements from CAPEX? And just given, again, going back to billions of reais of operating cash flow, how are you thinking about the cash position at year-end and the cash position at the end of 2023?

Alex Malfitani – Azul's CFO

Hey, Dan, yes, so I think you can compare 2022 and 2023. You have a huge increase in cash inflows from the expanding EBITDA. And it's not that we are expecting a much better environment in 2023 than what we're seeing today, right. We're essentially just annualizing what we're seeing today. If you have 12 months of the demand environment that we see, even with high fuel prices, even with the devaluation of the real, just the fact that we don't have Omicron, just the fact that we don't have an additional spike in fuel will already generate a ton more cash from operations than what we generated this year.

Then in terms of CAPEX, it's basically flat. In terms of rent, it's basically flat. In terms of interest, it's a little bit less than this year, but you can call it essentially flat. So I think in terms of outflows, you don't see a big difference. We don't have a lot of debt maturing and the debt that we had maturing this year, for example, we were able to roll because our creditors see the high performance of the business, right. So they love the interest and the revenue that we can generate for them. So really, the story of why 2023 is a much easier year in terms of cash flows than 2022 is the continued recovery and margin expansion. And then in 2024, you essentially get to breakeven, maybe slightly a little positive depending on how John mentioned if we get a couple of things going our way instead of going against us.

John Rodgerson – Azul's CEO

Dan, I just want to highlight a couple of other things on the cash front, right. We have BRL2.4 billion of reserves and maintenance deposits, right. And so when you talk about, and inside the quarter, there's two things that I think you need to look at the numbers that are really interesting is we spent BRL300 million on CAPEX in the quarter, and we also paid reserves, excuse me, our reserve balance increased by BRL300 million in the quarter, right. And so that gives us more flexibility going forward with fleet transformation, working with our partners. And then the BRL1.4 billion that we paid is a deleveraging process, right. And so if you kind of say, hey, if cash may get tight, maybe deleverage a little slower, right. And so those are opportunities, and I think we're, I want to keep in mind, we are an unsubsidized airline compared to all almost all U.S. carriers, compared to almost all European carriers. We've gotten through this, and we're exiting this pandemic with a lot of unencumbered assets, right. And a very strong business. And so not only did we not get help from the government, right. Our economy was devastated with the devaluation of the real and the increase in fuel prices.

And so Alex, I look at you and say, hey, we've never seen Abhi deliver the revenue numbers that he's delivering today, right. And so that is unbelievable blessing and that demand hasn't slowed. Abhi said to the earlier question that sequentially it's actually going to go up again. And so if you continue to have those numbers in there and then where you can be flexible, is you can be flexible in your reserves, you can be flexible in your CAPEX, you can look for financing opportunities on CAPEX. We didn't really finance much CAPEX this year, right. And there's lines and opportunities to do that.

Daniel McKenzie – Seaport

Terrific. Thanks so much you guys. Appreciate it.

Operator

Okay. Our next question comes from Savanthi Syth sell-side analyst with Raymond James. Syth you have the floor with the mic is on for you. Go ahead.

Savanthi Syth – Raymond James

Hey. Good morning everybody. If I might, just a quick follow-up on the cash flow and balance sheet side, but a bit more from a cost perspective. Could you talk about like the number of aircraft that you're getting in the next couple of years? And just kind of what you're seeing in terms of financing costs?

Alex Malfitani – Azul's CFO

Hey Savi. So the guidance stays essentially the same as we've discussed before. The fleet will stay basically flat. But as E1s get their end of lease or as we are successful in additional negotiations to accelerate the exit of the E1s, we'll see the next-generation aircraft, mainly the E2s coming in right. And just to remind everyone on the call, John already mentioned that the E2s are bigger by 18 seats.

In terms of cargo capacity, they're bigger by about 50%. They burn 15% less fuel in total, right. So about 30% less fuel per seat. And we are going to pay less rent on these aircraft than we pay on the E1s, right. In spite of the fact that we're taking these aircraft 12 years later than what we than the original delivery of E1s, we're paying less in rent. And most of those rents are already fixed, right. They're not going to be we negotiated all of those already. And so we don't have a bad guy in terms of cost of capital, in terms of the cost for the aircraft that's coming in, which is actually a great reminder because we do have competitors who are a lot behind us in the fleet transformation process, as John mentioned. And they will be exposed, they will be replacing aircraft that maybe today cost $100,000, $150,000 a month with aircraft that may be costing them $400,000 a month, right. And they will not see the upgauging that we're seeing because they're going to be essentially replacing like-for-like, right. So not only are we ahead of the curve, but I think even as you project forward, that advantage will continue.

John Rodgerson – Azul's CEO

Yes, that's absolutely critical, as Alex stated. People that are embarking upon their fleet transformation now are going to do it at a significantly higher cost than someone that's farther along on that journey. And so I think that's a reason that I think fares and capacity discipline will exist in Brazil as our competitors will have higher cost of ownership going forward.

Savanthi Syth – Raymond James

So that's helpful and that's good to know. I didn't realize they were kind of all fixed in. And if I might, I don't want to steal any thunder from the Investor Day, but just maybe high level with the Congonhas, the changes that are going on there. Could you talk about like what that might mean to stage length utilization yields or revenue? Just how we should think that about how that might impact us, how we start modeling the P&L?

Abhi Shah – Azul's President

Hey, Savi, in general it will be lower stage length because it's more corporate stuff. Utilizations actually might even get better because today, at the slots that we have are not very efficient, right. And so we have to use a lot more airplanes than we'd like. Now once you have more slots, you actually have more opportunities to improve aircraft rotations. And so I think utilization will be flat or a little bit better. Stage length will come down a little bit, just the nature of the market. But most importantly for us, it's going to allow us to access a customer that doesn't fly us today, right. We are small in Sao Paulo. And we're really excited to access this customer because we know that they will fly us out of Congonhas one week and the next week they will fly us to Lisbon or Orlando, for example, or pick up our credit card. And so I think that there's just a lot of network and overall benefits to having access to this kind of customer, which we haven't had. And now we're going to be able to serve the top five, six markets out of Congonhas, which is going to significantly increase our relevance overall.

Alex Malfitani – Azul's CFO

And one thing that's exciting about Congonhas for us is the way it fits with our flexible fleet, right. Because if you look at the demand in Congonhas, you do not need a large narrow-body throughout the day, right. You need it early in the day, you need it maybe late in the evening. But during the day, the best aircraft for that airport is the aircraft that we fly, right. And so we will be able to essentially get the same revenue as everybody else that's flying a large narrow-body, but we will have a much lower cost per trip because the E2 and even the E1 has much lower cost per trip than a large narrow-body, right. During the day, you're wasting a lot of that capacity because there just isn't enough demand for you to fill a large narrow-body aircraft in Congonhas.

Savanthi Syth – Raymond James

Good point. Thank you.

Operator

We now have a question from Bruno Amorim, sell-side analyst with GS. Bruno the mic is open for you now sir. Go ahead and ask your question.

Bruno Amorim – GS

Hi, thank you very much. So my question is a follow-up on the cash flow dynamic. Just wanted to validate the numbers behind it with you. So first of all, if we look at the third quarter numbers on an annualized basis, so EBITDA of BRL925 million on an annualized basis BRL3.7 billion. And if we run the same analysis for CAPEX, leasing and financial expenses, I'm guiding to an annual cash burn of BRL3 billion roughly from a simplified cash flow calculation perspective, which means that all else held constant, the company would have to increase annualized EBITDA from BRL3.7 billion to BRL6.7 billion. So first of all, I just wanted to confirm if this math makes sense to you, the cash neutral EBITDA would be around BRL6.7 billion?

And the second question also related to that is, how do you intend to finance the cash burn going forward? I understand the BRL3 billion, which is the run rate will decrease going forward as you have already mentioned, but it will still be negative. So is it possible to make it more explicit? How do you intend to finance this cash burn over the next 12 months? Thank you so much.

John Rodgerson – Azul's CEO

Hey, Bruno, just to kind of highlight, obviously you can't take third quarter and project going forward because you missed Congonhas, you missed more E2s, you missed the strength of the network and the increase of fares that Abhi has been doing and the growth in our subsidiaries, right. What we're doing in TuboAzul, we're doing in our cargo business and also what we're doing in our packaging business.

So our number is that BRL5 billion in 2023, not the BRL3.7 million that you annualize. So that already kind of takes your number in half. And then there's also, a lot of what you're seeing in the cash burn is CAPEX or paying down lessors faster than maybe we'll end up doing, right. And so it's in the best interest of all of our stakeholders for Azul to remain a strong airline going forward, right. And so do they need to get all their cash paid back in 2023 and 2024? Maybe that gets extended out, right. We've run a great business that's generating an enormous amount of operating cash flows. And I think that that's the way. And then if you look at it, right, when you talk about financing, we're spending all this cash in CAPEX and haven't had the ability to finance it, right. And so our team is working on the ability to finance CAPEX, engine overhauls and those types of things, but I'll let Alex give more color.

Alex Malfitani – Azul's CFO

Yes, so as John highlighted, the EBITDA that we're projecting and the cash flow from operations that we're projecting for 2023 starts with a 5, it's much higher than the 3.7. And again, just annualizing what we're seeing today and adding on some things that are absolutely certain, like the Congonhas slots or the fleet transformation, right. There's not a lot of additional optimism embedded in that projection. And that makes the cash flow gap for this year for 2023 smaller than 2022, right. And we were able to finance the cash gap in 2022. Obviously, we didn't have access to the capital markets. I mean the cash cap that we're talking about with stable kind of normal capital markets would be one transaction, right. It would be one debt deal like we did last year. It's very easy to finance that cash gap with normal and stable capital markets.

Obviously, you're asking because capital markets are very volatile today, but we didn't have access to the capital markets in 2022 either. And we were able to finance a cash gap that was bigger than the cash gap that we will have in 2023. And how are we going to do that? I mean we're going to do it as we've been doing. I mean we've been getting the question on cash and access to capital for the last 2.5 years, and we understand where you're coming from. But the best way for you to get comfortable is just to see what we've done over the last 2.5 years, right. We have had access to capital throughout. We raised that when we had infinite liquidity. So, the fact that we're going to have liquidity, sorry, infinite leverage, right, we raised that with infinite leverage.

So the fact that we're reducing leverage and we're delivering our leverage guidance faster than we expected shows that we are a financeable business. It's just that we have many different alternatives to finance our needs. And we're going to deploy them as necessary. It's just a very long list because that's how we've always operated, right. We've always had an A plan and a B plan and a C plan. I'd like to remind everyone that we plan to originally go public in 2011. We ended up going public in 2017. And we never slowed down our growth. We never deviated from our business plan because of lack of access to capital. It took six years longer than we thought to go public, but why didn't we slow down? How did we get to not slow down? Because we had a plan B and a plan C and a plan D. And that's always how we're going to continue to operate.

And for you to get comfortable is just to look at the last 2.5 years, that's how we've been managing throughout this pandemic.

Bruno Amorim – GS

Thank you very much.

John Rodgerson – Azul's CEO

And I just want to highlight one other thing is, we exited the pandemic, no government subsidies with our loyalty program are 100% unlevered. They're packaging business. We have an investment in a European carrier. All of these assets, we've never done a spare parts deal, right. So you kind of look at it overall. We still have a lot of options. We don't think we're going to need those, but I just that should give you the comfort you need.

Bruno Amorim – GS

Thank you. If I may just a quick follow-up since you mentioned, if we go with your number of BRL5 billion EBITDA for next year under the current levels of CAPEX, leasing and financial expenses, that would assuming an additional BRL1.5 billion to BRL2 billion cash burn to be financed at this point. Do you know already how you're going to do it or you have plenty of options and you have still not made a decision on where to pull the trigger?

Alex Malfitani – Azul's CFO

Exactly. I mean, we don't need it now, right. And so when we have to pull the trigger, we'll look at the options that are available to us, and we'll choose the best one for Azul to preserve value for all stakeholders as we've done throughout the pandemic.

Bruno Amorim – GS

Thank you very much.

Operator

Okay, our next question comes from Stephen Trent, sell-side analyst with Citi. Stephen, the floor is yours. We're opening the mic. Go ahead sir.

Stephen Trent – Citi

Thank you very much, everybody, and appreciate you taking my question. Just two quick ones if I may. As you think about those incremental slots at Congonhas, any high-level views on where you see an opportunity to grow out of there? And sort of any color on the competitive body language at that installation now that you guys are going to have a bigger presence? Thank you.

Abhi Shah – Azul's President

Hey Steve, Abhi here. So we haven't announced our network yet. We'll put it for sale in a couple of weeks. But look, it's not going to be too much of a surprise. It's the largest corporate markets that are out there. And again, as I said before, it's going to allow us to have increased relevance in the São Paulo market and it's going to allow us to capture that customer and then they can further sort of navigate the Azul ecosystem. So that's what the benefit is.

I think honestly the market is disciplined. I think the market has to be disciplined. I think it will continue to be disciplined. I think that all the airlines are doing what works for them. And we're seeing good discipline in the fare environment. I expect that to continue overall. I don't think anybody has any empty space to kind of mess around a little bit, if you. So I think overall, the market is going to be disciplined. That's certainly our intention to continue to be that way.

Stephen Trent – Citi

Super, appreciate that Abhi, and just one very quick follow-up. When do you guys think about sale leaseback opportunities, especially as you're onboarding newer planes, do you think we could see kind of similar levels of activity going forward, even as I recognize the danger of trying to take 3Q and annualizing it because of seasonality? Thank you.

Alex Malfitani – Azul's CFO

Yes, we're seeing actually that market improving at the margin, Steve. We have all of the aircraft that are coming are already financed, right. So there's no kind of uncertainty there. But for future orders that come directly from our order book, sale leasebacks are certainly an option. We also have some owned aircraft still in the fleet, right. The announcement that we made of accelerating the fleet transformation with the exit of the E1s involve some actual sale of aircraft, right, actual outright sale of the aircraft. And we still have a few of those in the fleet as well that we can take advantage, right. Those are kind of within the many options that we have to finance our operation going forward.

Stephen Trent – Citi

Okay, appreciated. Thanks, Alex.

Alex Malfitani – Azul's CFO

Thank you.

Operator

Okay, now we have Marcelo Arazi, sell-side analyst with BTG Pactual. Please Marcelo Arazi, you have the floor, the mic is yours. Go ahead and ask your question.

John Rodgerson – Azul's CEO

I think you maybe on mute.

Abhi Shah – Azul's President

Okay, well we can read the question here. The question is, when will we start operating the new Congonhas routes? We will start flying the routes in the northern summer season, so that starts end of March. March 28, 2023 is when we start flying the routes.

Operator

Okay. Now we have a question from Rogerio Araujo, sell-side analyst with Bank of America. Rogerio, the mic is yours. Go ahead and ask your question sir.

Rogerio Araujo – Bank of America

Thank you. Hi gentlemen, good afternoon. Thanks for the opportunity. I have a couple here. One is you mentioned in the release a change in the provisioning policy for the return of aircraft. Could you please provide more details on this change? And also my second question is on sale and leaseback gains. Can you confirm if there was a BRL321 million gain this quarter? And if so, if you could provide more details on that and what you expect for upcoming quarters would be great? Thank you.

John Rodgerson – Azul's CEO

It would be fantastic if we had a BRL321 million gain.

Alex Malfitani – Azul's CFO

No, so Rogerio, we started, obviously as the new airline with brand-new aircraft and so we didn't have a need to provision for deliveries for a very long time. As we get closer and we're starting to deliver these aircraft, we implemented a provisioning policy. I think, not mistaken Q4, but we can get back to you if that's incorrect. But essentially, we're looking at the next 36 months and starting to provision for the cost of redelivering the aircraft that fall within that window. And so on a year-over-year comparison, you see a change there because we didn't have that provision before.

So I think you're referring to the reversion of the impairment of these E1. So it's very technical, but we're essentially the gain that there is that happened as a one-time gain today this quarter on our results is the comparison between the cash that we're getting on the sale of the aircraft versus what was provisioned. Both were provisioned both on the asset side and the liability side for these aircraft, right. Because of our IFRS 16, you have to provision the right-of-use asset for the aircraft. When we impaired it, we made an assumption of when these aircraft were going to leave. What was going to be the incremental cash inflows that we were going to get for those aircraft was the incremental and the continuing cash outflow that we're going to get for those aircraft. That ended up being a net number that we provisioned in our balance sheet.

And the impact, the gain that we saw is really the change between the number that was on our balance sheet and the cash that we're getting for these aircraft. But on a more simple basis and maybe more relevant for a cash perspective, we do have aircraft that we still own that have a market value that's higher than the debt that they still have on the balance sheet. That's really what matters, right. And so that is a potential source for additional cash in the future if we choose to utilize it.

Rogerio Araujo – Bank of America

Thanks, Alex. Yes, actually there is a line in the cash flow in the release called operations of sales and leaseback. This is where I get the BRL321 million, so if you could check that, we can speak afterwards. Thanks very much.

Operator

Okay. Now we have a question from Josh Milberg from Morgan Stanley. Josh you have the floor. The mic is yours. Go ahead and ask your question, sir.

Josh Milberg – Morgan Stanley

Hey everyone, thank you very much for the call sir. Just a follow-up on the issue of the financing of your cash flow gap. You guys made reference to the tap bonds. I don't think you touched on the issue of a potential renewal of the codeshare with United. And I was just hoping you could actually give a little bit of an update on both of those potential sources of liquidity. Just some more detail on them in what you're thinking there?

John Rodgerson – Azul's CEO

Josh, the issue with United and they've been a great partner with us is that when they gave us capital seven years ago, it restricted our ability to do certain things. And so as you see us expand our network into Florida and our partnership with JetBlue, a lot of what you're seeing in those destinations wasn't possible under the old agreement with United Airlines, right. And so we still have a good relationship with them. We have a codeshare in place with them.

And so we're talking to them, but there's no urgency to do something at this time because we need, when we did that original agreement, we didn't even fly internationally, right. And so when you think about strengthening our network and doing stuff for the long term, and so was the ability to maybe get something right up front and extend the contract? Probably, but we need to do what's good for Azul long-term and think about our long-term growth overall and that's what we're looking at. And so a very friendly relationship, United is still on our board and, but we have opportunity to do other things with other airlines, more specifically JetBlue in Fort Lauderdale. And if you think about what JetBlue is doing in Fort Lauderdale with Spirit, in our flights, we have double dailies from Campinas. We have Manaus, Belem and a lot of capacity going in there, that connectivity is really important to us going forward.

Alex Malfitani – Azul's CFO

Yes. And I think those are two good examples, Josh, of opportunities that maybe are available to us and that aren't available to everybody else, right. The tap bond is a unique asset that has value, right. We have a view on what that value is and we're going to track the market to see if that view aligns with the market's view. And if it does, maybe we can sell that asset. It's not an asset that we're married to, right. Like any assets, we want to see it being recognized for the right value.

As John mentioned, a potential exclusivity agreement has some value for cash, but it also has some strings attached to it, right. And then we're going to look at the value that the potential agreement brings and we're going to decide whether that's our best source of capital or look at the competing sources of capital and choose the best one for us at the moment that we need the capital, right. That's what we've been doing over the last 2.5 years. We're going to be very pragmatic and very technical about making sure that whatever capital we access is priced correctly.

John Rodgerson – Azul's CEO

And we're playing from a position of strength, right. I mean, if we were out there kind of trying to get cash at any cost, that's really not for the good of long-term of Azul, right. And so we want to protect all of our stakeholders, our shareholders, our debt holders. And I think as a sell-side analyst, Josh, you have to appreciate that that's what we do. And that's how we protect all of our stakeholders going forward. And making sure we have the right agreement in place is way more important than closing an agreement.

Josh Milberg – Morgan Stanley

Those are great, very detailed responses. Just on the JetBlue opportunity that you mentioned, could you detail a little further what the nature of a potential exclusivity agreement might, what form it might take?

Abhi Shah – Azul's President

Hey, Josh, look with JetBlue, we have now connecting to over 25 cities in the U.S., six in the Caribbean. We just announced Nassau on the Bahamas this week. They're a great partner of ours. We're a great partner of them. We're going to have double dailies to Fort Lauderdale. This summer, we have doubled day to Orlando as well and other JetBlue hub, and we're excited about what they can do with Spirit as well in the future. So we're talking to them like we talk to everybody else about opportunities. Today, we have a codeshare, a large codeshare with them. Frequent flyer hopefully is on the table as well there. We have a good base of customers in South Florida.

They obviously have a huge base of customers in South Florida. So that would be interesting as well, but we're looking to evolve those conversations and strengthen our partnership.

Josh Milberg – Morgan Stanley

Okay. Thank you guys very much.

John Rodgerson – Azul's CEO

Thank you, Josh.

Operator

Well, that brings our Q&A session to a close. I would now like to give the floor back to John Rodgerson for his closing remarks. Mr.Rogerson, please.

John Rodgerson – Azul's CEO

We want to thank all of you for joining us today, and we'll be available for any of your questions and look forward to seeing you all in person on December 7. Thanks everybody.

Operator

Well, this concludes the Azul's audio conference call for today. Thank you very much for your participation. Have a good day, everyone. Thank you.