

## Conference Call

Azul

### 3Q18 Earnings Results

November 8, 2017

**Operator:** Hello everyone and welcome to Azul's 3Q18 results conference call. My name is Larissa and I will be your operator for today. This event is being recorded and all participants will be in a listen-only mode until we conduct a question and answer session following the Company's presentation. Should any participant need assistance during this call, please press \*0 to reach the operator.

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

**Ms. Andrea Bottcher:** Thank you Larissa and welcome all to Azul 3Q earnings call. The results that we announce this morning, the audio of this call and the slides that we will reference are available on our IR website.

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

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

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

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

**Mr. David Neeleman:** Thanks Andrea. Okay welcome everyone to join us for 3Q 18 earnings call. As always I would like to start by thanking our crewmembers at Azul for creating this great result for us. They are truly amazing and they do an amazing job every day. We are relieved that the Brazilian elections are finally over and that the macro economic environment in Brazil is more stable. We are very

optimistic with the new administration; they seem to be taking all right steps to promote economic development of the country. I have always been a great believer in Brazil. It is a huge country with a lot of potential. We have had a couple of tough years; but the future looks bright.

Going back to 3Q results once again we demonstrated our resilience in an extremely adverse fuel and currency environment while successfully executing on our long-term margin expansion plan. On the operational front we continue to rank as the most on-time airline in Brazil and we are also among the top five in all the world, incredible, an incredible accomplishment and I am proud to report that last month we were voted the best... We were voted the best airline in Latin America by Kayak customers, a leading travel research engine sweeping all categories, boarding, comfort, onboard service, entertainment and most importantly crewmembers who really make it happen.

We were also recognized by "Reclame Aqui", which is "Complain Here" which is a Brazil's consumer economic and advocacy website for having the highest standard of customer satisfaction and the fewest customer complaints YTD of all the other airlines. I could not be more excited about the quality of our service and our future growth opportunities.

Through our fleet transformation plan we have talked a lot about, as we told you many times we were replacing the E1s with A320s and they have similar trip costs with 56 more seats; and also the E2s that have 18 more seats with a much lower trip cost than E1s, and this is why we are actively marketing the E1s to accelerate that process and it is going well.

We have built an unbelievable network and now every new generation aircraft we add strengthens our airline even more by reducing our unit cost on a fuel and neutral basis our CASK - and John will talk more about this in detail - we would have down 6.8%, it is incredible. I mean to be down 6.8% YoY, I have never seen that from any other airlines and that is obviously because these NEOs have such a lower cost.

The performance of the A320s on our network has surpassed all of our expectations. Adding the NEOs for the sixth quarter in a row we have increased the capacity and RASK. These aircraft are flying an average of 14 hours a day and are bringing up our fleet a jet utilization rate to 12.6 hours a day, while improving connectivity across the airline.

At the end of the quarter we had 17 A320neos flying and only 27 out of 218 markets, representing 27% of our total capacity and these planes have a 29% lower unit cost. Every single one of these are desperately needed and we will

continue to do so for many years to come. When one arrives we stick it where it is needed and we have so many needs to these aircrafts. It is a real party here every time one is delivered. No other airline in the world is transforming its fleet as significantly as we are replacing 118 seat aircraft for next generation 174 seat airplanes and then starting next year our fleet transformation accelerates when we start adding the E2s mid-19. So those will come (incomprehensible 5:40) are coming.

With both these generation aircraft we are creating a competitive, sustainable advantage which will continue to drive margins higher and allow us to offset any future macro headwinds we may encounter.

In summary we are confident on our margin expansion plan that we told you from the very beginning. We were on the roadshow, that was our message and that has not changed and we will continue to communicate that message on our way to building a more profitable airline with the best crewmembers, the strongest network and the most reliable operation. I could not be more excited.

With that I will pass the word to John, who will give you more details on the quarterly results.

**Mr. John Rodgerson:** thank you David and hello everyone. I also want to thank our crewmembers for all their hard work in the past quarter. As you can see on slide five the core airline drove strong results in a tough macroeconomic environment. The 47% spike in fuel and the 25% depreciation of the BRL impacted our results by 323 million BRL or 16 margin points.

Thanks to our ability to raise fares and reduce costs through our fleet transformation we were able to recover 11 margin points reaching an Ebit margin of 7.1% for the quarter and a 28% Ebitdar margin while recording net income of 117 million BRL.

We grew capacity by 19% in 3Q while also expanding our top line by 23% and our RASK by 2.7%. On the stage-length adjusted basis our RASK increased 8% YoY. CASK X fuel decrease to 1.8% controlled for currency and fuel as David mentioned earlier CASK would have been down 6.8% YoY.

We received our 17 A320 in the quarter and the A320neos represented 27% of our 3Q capacity. The E2s coming next year will help us further accelerate the fleet transformation.

Moving on to slide six we can see that fuel and currency had a negative impact on our results in 3Q, which represented 16 margin points. Thanks to our margin expansion strategy and our visibility to recapture revenue we recorded an

operating margin of 7.1%, recovering 11 of the 16 margin points in a very challenging macroeconomic environment.

Moving on to the revenue performance on slide seven we continue to benefit from a healthy demand environment and robust ancillary revenues. Considering that average stage length increased 11% in 3Q our RASK adjusted for this increase rose 8%.

Our network advantage allowed us to grow capacity by 19% while increasing average fares by 11% and at the same time increasing load factor. Once again we increased capacity, yield and load. This shows the network really needed the A320s.

Moving on to slide eight our loyalty program TudoAzul maintained the strong growth pace during 2Q reaching 10.5 million members. Gross billings ex-Azul went up 36% YoY with the majority of this increase coming from our TudoAzul club and our banking partners, further increasing our share of the Brazilian loyalty market. As you heard us say all along our decision not to spin off TudoAzul proved to be the right one. Our competitors have all backed away from having a separate loyalty company. We now have 17 gross billing share up from 14% just one year ago and still well below our fair share of this market.

On the right-hand side of the slide you can see that our cargo business is also performing well. Revenue increased 63% YoY. In October we deployed our first dedicated cargo airplane into our network and that is already flying with a 19% load factor. Clearly our cargo team earned the right to get these planes into our network.

Moving on to balance sheet on slide nine I am proud to report that we ended the quarter with an even stronger liquidity position representing 46% over our LTM revenue, while also reducing our total debt position by 100 million. Taking advantage of our comparable liquidity position and high credit rating we eliminated all restricted cash in 3Q.

Even with the strong depreciation of the BRL we ended the quarter with leverage at 4.2 compared to 4 in 3Q 17. This result reflects our decision to hedge 100% of the principal and interest payments for the 400 million USD denominated bond issued in 2017, protecting ourselves against currency risk.

Our low currency exposure is reflected on slide 10. Only 33% of our balance sheet debt is denominated in USD and virtually all of our working capital debt is denominated in local currency. Additionally as you can see on the right side of the slide we continue to be long USD. Our assets denominated in foreign currency,

namely our cash deposits and maintenance reserves abroad and our investment in TAP surpassed our dollar-denominated liabilities - and that excludes aircraft and spare parts, which are not restated the exchange every quarter but are also priced in USD. For this reason in times of weakening currency we have strong assets denominated in foreign currency that naturally protects Azul. We are not nearly as impacted as our competitors. This reaffirms our position as the airline with the strongest balance sheet in Brazil.

Moving on to slide 11 we have been proactive in adjusting our capacity to the changing fuel and currency environment and our capital growth at the lower end of our guidance. As a result we expect our operating margin for the year to be around 9% and our CASK X fuel to decrease around 1% YoY.

We expect to release our 2019 guidance together with our 4Q results in March, which will also include an estimate of the impact of our IFRS-16 without a preliminary analysis we expect to see a large increase in Ebit compared to the current accounting standards, as well as a significant reduction in debt and leverage.

We will continue to execute on the pillars of our margin expansion plan shown on slide 12. Our goal reaching an operating margin of 15% by 2020 has not changed. Our fleet transformation strategy is working and now that we have a more stable macro environment in Brazil we are even more confident on our ability to expand margins over the coming years.

We have built the strongest network in Brazil, we have a solid balance sheet and have great customer service. I could not be more proud of our 11,000 crewmembers. With that I will turn the call over to the operator for Q&A.

### **Q&A Session**

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

Our first question comes from Savi Syth with Raymond James.

**Ms. Savi Syth:** hi there and good afternoon guys, great results here. I know you do not provide RASK domestic and international; but if you would not mind providing some color on may be a kind of yield demand in the two different areas, generally how it trended in 3Q and what you think is going into 4Q?

**Mr. Abhi Shah:** Savi, Abhi here. So yes I would say that the strong overall RASK increase of 8% adjusted for stage I would say was mostly driven by strength in the domestic market. So I talk about that for international. It is hard to believe the World Cup was in this quarter, it seems like a lifetime ago; but we saw a strong balance in bookings post World Cup, very good August and very good September domestically. September was one of our highest domestic RASKs ever in the history of Azul, which is surprising to me frankly given the fact that we have 17 A320s flying, which mathematically should bring the RASK down, so very strong at the domestic side.

If you look at our corporate revenue for the first nine months of the year in Abracorp, which is a corporate travel agency revenue, we grew the most in revenue and we also grew our average fare the most, even though we already have the highest fare. So I would say strong domestic environment. It continues today, October was good as well other than a small interruption due to the elections, November has picked up nicely and that continues to be our focus, it is the A320s are all flying domestically other than one route, the E2s are all focused domestically. So that is really our focus the next two, three, four, five years. I really see a lot of opportunity on the domestic side and so that has driven most of the RASK increase overall.

On the international side dollar did impact demand, definitely other airlines as well - we talk about the LatAm regions - so it is not too surprising; and we have adjusted capacity accordingly. So we have made strong capacity adjustments. If you look at the tapes September, October, November and we were down pretty significantly international capacity and we have extended those cuts out through May next year, just to give it some time to rebound because it is a longer booking curve and then June and beyond next year we will look to see if it makes sense.

So I am very comfortable with the international capacity, we have made the right adjustments. It is a good base level of capacity and if you look at our traffic results our international has held that better than the other players in the region. We had an 87% load factor in 3Q, even with the USD very high. So I would say internationally stable and we have made the right adjustments to account for the impact of the currency; but I am really excited about domestic demand. It did run 3Q and continues to do well and that is going to be our focus going forward.

**Ms. Syth:** helpful and if I may just follow-up on cargo. Could you provide an update on the JV? And I think you have one already; but maybe two dedicated freighters coming. Would you put that into service even before the JV commences? What is the plan on that cargo side?

**Mr. XXX:** Savi we already have the one cargo plane in operation and it is going really well as I mentioned, it has a 90% load factor and so we have been able to stop flying our 320s domestically because of a couple of big cargo contracts that we have, and so we are very excited to have those. The government has changed the president of the Correios, in the last months it has changed three times; but I was most recently with the new president that was just appointed last week and he is very much in favor of the deal.

So we need to let the process play out with the antitrust; but we provide a great service to the Correios and we will give them a significant cost reduction from what they are paying today and so I think everybody is in favor and I think the new government is very much in favor of privatization. So I think the election certainly helped the joint venture going forward. So we are excited but we have the plants to get these cargo airplanes independent of that because we have got some great contracts with some partners of ours and they are going extremely well.

As you have seen we grew cargo in the quarter by 63% and so it is pretty exciting the cargo business that we have built.

**Mr. XXX:** there is only one airplane flying now and then the second will fly... In December.

**Ms. Syth:** all right great very helpful, thanks again.

**Operator:** our next question comes from Renata Faber with Itaú BBA.

**Ms. Renata Faber:** hi everyone thank you for the call. My question is regarding the IFRS-16 and the impact that is going to have on your balance sheet.

**Mr. XXX:** hi Renata. So we have done the work and we have the preliminary results. What we are trying to do is to dot the "is" and cross the "ts" and also get the best from our orders and we are going on the right direction; but it is pretty straightforward. You can see that we have more rent than anybody else and the rent is going to be capitalized right? Because with IFRS-16 everything that is in operating lease gets treated as a finance lease right?

So the benefit to Ebit and the benefit to debt and to the leverage to Azul should be higher than two airlines that have less rent expenses. Also we still expense a lot of our maintenance and that also gets capitalized. So there should be a big impact

too to Ebitda and debt and we will provide that once we know the numbers with certainty.

**Mr. XXX:** Renata I just wanted to add to Alex's comment that these off market leases that we have on the E1s they go away over the next two or three years and so when we capitalize it and put it on the balance sheet next year some of these are going on from one year, two years, three years and so the impact on our leverage is very minimal and so we are actually going to get the good guide in Ebit and a significant good guide on leverage. So that is something that we are excited about.

We talked about getting to a 15% operating margin in 2020 and that is independent of the IFRS changes, so the IFRS is only going to make those numbers look better; but we are pretty excited about the changes. It kind of levels the playing field for everybody, so everybody will be accounting for maintenance, the same way accounting for aircraft rent and debt the same way. So it will be exciting show our numbers next year in comparison to all airlines in the world.

**Ms. Faber:** okay thank you and a question for Abhi: Abhi you said that most of the RASK improvement came from the domestic market. Now that the BRL is appreciating probably the cargo will start to do better. Do you also see room to increase yields in the international?

**Mr. Shah:** I definitely see room to increase yields and I think that is going to happen slowly over the next couple of months as the currency stabilizes at this level. I think customers will get more confidence in their currency being stable and that is going to drive more demand back to us international. So yes I definitely see room for yield expansion.

It is a longer booking curve, so it does take longer to realize those benefits in the flowing data, which is why we have kept our capacity all the way out through May of next year to give ourselves and the market some time to recover and then I think past June, July of next year if this trend of improvement continues then perhaps we are looking at some new capacity internationally; but for now we will let the market recover, let the market develop and I think yield is going to be the way that happens.

**Mr. XXX:** Renata this is important: we cut capacity from our expectation because of Airbus delays and so I think as you look at it it is not like we are burdening ourselves with additional aircraft rents that were not flying; and it in fact the Airbus has delayed significantly on the A320neo program and that actually could be a benefit to us in a weaker international our environment. So those get moved to the

right a little bit, so I do not want you to think we were burdening ourselves with those aircraft that we were not fully utilizing.

**Ms. Faber:** okay thank you.

**Operator:** our next question comes from Bruno Amorim with Goldman Sachs.

**Mr. Bruno Amorim:** hi good afternoon. I have two questions on tax benefits, the first one is what to expect for 2019 in terms of payroll taxes? Any change vis-à-vis what you had to pay or not in 2018?

And second on the tax benefits on some of these states where you operate in Brazil any expected change in those benefits under the new administration in Brazil from January on? And also any color you could give us in terms of the amounts of those benefits currently would be helpful as well thank you.

**Mr. Alex Malfitani:** Bruno Alex here. So on the payroll tax burden as you know it was expected to come back in; but right now we are not paying it, we are under the incentive mode still. With the change in the government I think that is something that we thought was almost a certainty and that was actually included in our guidance originally.

Now we do not know. So it is a new government and we have to see how they are going to go about taxes in general and so when we put out the guidance for 2019 hopefully we will have a clearer view and then we will communicate accordingly whether the burden is in or not.

**Mr. XXX:** and Bruno on your second question on the individual tax agreements we have in each state it is important to highlight to everybody that we fly to 101 destinations domestically in Brazil. Nobody comes even closer to what we do and so when we sit down with the Governor and have a lot of air service in their state it is essential for economic activity.

That is something that we are proud of that we have done and it is a great partnership that we have with the states and so we do not see that changing, we see that actually enhancing. We are the only ones in Brazil with that diversified fleet, that flies the ATRs, that flies the E-jets and flies the A320s domestically so we are bringing essential air service to a lot of different places and so every time we go on to a state this is positive for them from a tax base perspective.

**Mr. Amorim:** that is clear thank you very much.

**Operator:** our next question comes from Dan MacKenzie with Buckingham Research.

**Mr. Dan MacKenzie:** good morning thanks guys. My question with respect to the IFRS-16 impact. We continue to model the FX volatility in that particular way, it does not change that, just as a housecleaning question.

**Mr. XXX:** I am not sure I understand. It is going to go on the balance sheet once; but you should know there should not be volatility from a P&L perspective but the data on the balance sheet will adjust up and down, Dan, but where is now my aircraft rank goes up and down based on FX and you will see a lot more stability as it relates to our Ebit margin if you will.

**Mr. XXX:** I think the way to think about it Dan is just like finance lease. So today we do have some adjustments on the finance leases on the liability side because the debt gets repriced every quarter and the asset does not; and that is why the whole industry does not pay a lot of attention to net income. Obviously it is an important metric but it carries a lot of noise, a lot of non-cash impact every quarter and that is going to get somewhat a similar kind of effect on the op leases, which will now be treated as finance leases.

Our expectation as John mentioned we are looking forward to the change because it will provide a lot more standardization and more of a level playing field to look at the airlines that have finance leases and op leases in a similar way and make sure that everybody is accounting for it similarly. But I think the same ways the whole industry focuses a lot on Ebitdar maybe they focus a lot on Ebitda or Ebit - but there will still be noise on the net income line. Ebit and Ebitda will still be the more stable numbers that will provide a better view at how well the airline is effectively operating.

**Mr. McKenzie:** that is great clarification, I appreciated that thanks and then I was a little bit late joining the call and I am not sure if you talked about your updated defleet transition, just if we factor in the E2s the percentage of the fleet that would be up gauged at the end of 2018 versus 2019 and 2020?

**Mr. XXX:** Dan we are working actively on that. We do not have news at this point; but we are going to be ahead of plan, from what we had previously committed to the market as we exit our E1s and pull forward E2s and so we will give you more details the next time we catch up on that because I want to make sure we close out some of these agreements - but we are ahead of schedule from where we wanted to be and that is what makes us so excited about the future.

The airline today is performing really, really well. Imagine how it is going to look like when our entire fleet, the A320Neos and E2s at 29% lower seat cost, the same trip cost and E2s at 26% lower seat cost. It is going to be a phenomenal transformation and it is going to happen over the next couple of years.

**Mr. XXX:** Dan... This is a brand-new airplane and this is being certified. It is just engines, obviously we are not worried about the performance of it; but (incomprehensible 27:06) everything is settled and we do not know is actually which month we are going to receive the first one, it is moving one month this way or that way and how many we can receive in the year. But we are committed to taking absolutely as many as Embraer can deliver to us in our spec and the way we wanted for our customers. So we do want to take delivery... Redo the airplane as it comes in and so it may move one month the other way and so Embraer is motivated to deliver as many planes as they possibly can and so they are working really hard to make the plane exactly the way we want it and give us as many as they possibly can.

**Mr. XXX:** we at natural leases that are coming off next year, 6 to 8 that are coming off anyway next year and now we are actually remarketing and we are going to accelerate that further.

**Mr. McKenzie:** very good. If I can just squeeze in maybe one, my two last point here. Abhi there has been a lot of macro volatility in Brazil and I am just wondering if you can provide a little bit more granularity with respect to the main volatility. Even as good as the prep was in 3Q I have to believe that there was a lot of travel that did not take place and I am wondering if there is any pent-up demand that could potentially manifest in 4Q here and early 2019 as FX stabilizes, I guess that is one.

And then following up on a couple of other prior questions just legislators' priorities. O do not know if you guys talked a little bit about tax and other things; are there other legislator priorities in the vault that you guys are watching that could potentially impact the business directly or indirectly next year?

**Mr. Shah:** Dan I will take the first one about the demand. Looking back to 3Q it was pretty smooth post-World Cup. So if you go back even further you remember the truckers strike and the World Cup and it through the middle of July. From then on it was pretty smooth and there definitely was repressed demand prior to that and that came strong end of July, August was very good and September as I said was one of our highest ever domestic RASKs in our history.

Being more current October was also good but we had the elections, the first and the second round which in those weeks and particular we saw a little bit of drop off in demand most due to the distraction effect or people not willing to travel during the election week. That I do expect will bounce back as I think it will now in November and towards December. So I would say in 3Q there was repressed demand from the truckers strike and the World Cup which came in strong. I think

what we are seeing now is some repressed demand from October in terms of the election - but that is coming in nicely as well and the forward curves are building strong for November, December.

One thing that has jumped out at me is our load factor. I have never been a load factor guy, we have never had load factor targets; but our load factor is probably higher than it has ever been and one reason is that the A320 is driving great connectivity throughout our network and that is helping the smaller routes, the E-jet routes, the ATR routes; and as I look ahead that load factor momentum is continuing into early next year, which is giving us a lot of confidence to be aggressive on the yield side. So I expect that momentum to continue in terms of demand domestically.

Internationally I think it is going to recover as well mostly on the yield. Our load factors are already 85, 86, 87 and I think that those yields will recover as the currency stabilizes the next couple of weeks and months.

**Mr. XXX:** I think Dan I will pass out to Alex to answer on your question on the reforms; but keep in mind fuel downed significantly over the last 60 days and the currency has also strengthened a lot over the last 30 days considering the elections. So those are also too big benefits that we will be seeing as we move forward. That brings a lot of the optimism and the country seems to be back to work.

People are pretty excited about the future and it just needed to have the election get behind this, everybody is now focused on moving forward. I think the country really has come together and the current government is talking about reforms and the new government that is formed is also talking about reforms.

**Mr. XXX:** yes Dan and I think there is so much optimism here because obviously if the reforms happen - and we have a lot of confidence that they will happen - it will be very beneficial to Brazil, and the best thing for Brazil in general and specifically for our sector is for Brazil to grow again. Brazil went through a deep recession for a couple of years, we still have not snapped back to even where we were prior to the recession. So there is still some room to grow until we get back to that level.

That is what David identified like 10 years ago when Azul started. The potential of the country is huge and over the last 10 years the industry has doubled in size; but the average GDP growth has only been 1.5% and so you can just imagine how this industry could do if GDP starts growing 2, 3, 4% as Brazil should be growing as an emerging market with a lot of potential that we see here.

So if you ask us the list of things that could be reformed and that would be beneficial to the country is huge and I think that is what the new government is seeing as well. There is a lot of opportunity, there is a lot of potential and I think it will be just a question of them to start coordinating, start aligning and negotiating well that the Congress to start pursuing all of these opportunities.

**Mr. McKenzie:** that is perfect. I will pass on to the next guy, I am excited a lot with the reforms myself.

**Operator:** our next question comes from Matt Fallon with Deutsche Bank.

**Mr. Matt Fallon:** hey guys Matt for Mike here. I know you addressed this briefly; but could you give us a little more color on what impact the A320 delivery delays have on the capacity of allocation in the network plan?

**Mr. XXX:** Hey Matt. So initially we were looking at getting A320neos in service towards the end of this year. We were always informed along with other operators that the airplanes would be delayed towards the end of January if you will, which would be past our high season, our summer season and so in that case we said well, we will delay a little bit further because we do not want to take those airplanes in the middle of low season.

So in that case we pushed them to the right closer to the next high season, which is in June, July timeframe. So that has delayed the start of a couple of new markets, which in this current environment we are perfectly comfortable with and we will now time them to take advantage of the next high season that is the southern winter, the northern summer if you will are on the late May or June timeframe.

So it is still not clear whether we will get one or two A330s in flux; but I expect that the first A330Neo routes will only start service late May in that early June timeframe.

**Mr. Fallon:** thanks. Just two quick follow-ups: one could you give us a read up on 2019 capacity and the second is this 70% recapture, do you think past performance can continue in 4Q and beyond? Thanks.

**Mr. XXX:** in terms of capacity for 2019 I think it will be similar. I think you will see domestic a little bit more representative, so I think this year domestic was 8 to 10, this year I think it is closer to 8 and I think next year it will be closer to 10 and international will be in the 40% range for an overall capacity growth of around 18%, something like that. This year our initial guidance was 18 to 20 and then we brought it down to 16 to 18. So I would say very similar capacity growth overall, a little bit more biased towards the domestic side and that is where our focus is, that

is where I think the opportunity is anyway; and I think because we are getting the A320s as well as the E2s are coming.

**Mr. XXX:** and remember that that is all coming from upgauging right? It is one aircraft out, one aircraft in and better utilizing the assets that we have. Abhi talked to the recapture rate; but keep in mind that in 3Q we paid the highest fuel price we have ever paid at Azul and then the exchange rate was the highest we have ever seen sustained in a quarter. I think you hit 4.15 in the quarter but it averaged just under 4.00. So we are obviously in a much better place right now; but Abhi can talk to the demand environment and his ability to recapture.

**Mr. Shah:** so in terms of recapture there are two parts to this: one is revenue recapture, which is average fares, ancillary fees, all those kinds of things and basically RASK; and the other part is what we are getting in terms of what I call margin recapture, which is the efficiency that we are getting with the A320s and the E2s next year.

For us it goes very much hand-in-hand because RASK of course is affected by the capacity that we are putting in that is very, very efficient and lower unit costs capacity. Overall I do expect similar or better percentages in terms of recapture, yes. The mix between RASK and CASK could vary as capacity growths changes as we get more A320s, as we get more E2s and we really are able to lower our unit costs with those superefficient airplanes. But overall yes, I do expect similar or... I think we want to do even better in terms of overall margin recapture.

**Mr. Fallon:** thanks for taking my question.

**Operator:** our next question comes from Helane Backer with Cowen.

**Mr. Helane Backer:** thanks very much operator, hi everybody, thank you so much for the time. Just a quick question. I think this morning you announced a codeshare agreement with COPA and I am just wondering two things: one you have fairly high load factors and so what do you think the exchange and passengers will be? Do you have any expectations for revenue benefit from the codeshare, A from the codeshare and B from the frequent flyer exchange. So maybe you could talk about that a little bit?

**Mr. Shah:** yes. So this morning we did announce our codeshare with COPA and a bilateral frequent flyer agreement. I am very excited about this agreement. We have been talking to them for a while. COPA is a great airline; they operate more than 70 weekly flights into Brazil to nine different cities and so there is a lot of places that we can connect that are just not the two main international airports in

Brazil, São Paulo and Rio. Belo Horizonte, one of our biggest hubs, they fly Recife, one of our biggest hubs and all the other places.

So in terms of volumes I think it is going to be on par with the other codeshares that we have. We do not break it down by individual codeshare; but it is incremental demand and it is incremental demand in our spoke cities. Belo Horizonte, Recife, Salvador, Fortaleza, all these kinds of cities that COPA flies where they can really use the connectivity that we have and that is the benefit.

So for us it is incremental demand in big cities and for COPA it is additional connecting options for their customers as they are flying to Brazil. So I really think it is a win-win.

In terms of loyalty customers love using their points and we really want to allow them to use their points at our partners. So today our TudoAzul customers in addition to Azul can use their points on TAP, can use their points on United and COPA is going to be a great option for them, whether it is Latin America, whether it is the Caribbean or even some parts of the US. So I think it adds to the portfolio of our loyalty redemptions and I think it makes the program that much stronger.

**Ms. Backer:** thank you I appreciate your help with that.

**Operator:** our next question comes from Alberto Valerio with UBS.

**Mr. Alberto Valerio:** hello gentlemen thank you for taking my questions. I have three ones on my side, the first one would be if you could give some color on the reversal provision that it was in the results today.

**Mr. XXX:** the other operating expenses, the reversal of some provisions.

**Mr. XXX:** yes. So Alberto as you know other operating expenses is a kind of a mix bag, kind of catch all, there are a lot of different line items in that account, some of them going up, some of them going down; a lot of them are administrative and one time, they are not completely tied to the operation.

But out of the ones that I think are most relevant this quarter we revised some provisions for liability claims, some taxes and some cost of redelivering aircraft that we sold. So I think there is about a 20 million number that you can... That is a sort of the most relevant line, like I said a lot of things going up or down; but I think the most relevant would be a 20 million expense that we decreased.

**Mr. XXX:** but it all sums up to the 20 million. There is a bunch of other stuff in there.

**Mr. Valerio:** okay and I also saw some civil lawsuits that were reported. Could there be a recurrence cut of costs or would be just one time?

**Mr. XXX:** there are some that happens occasionally. Customers love, as you see from all the awards and recognitions that we get; but every now and then we mishandle a bag and that becomes a claim. But that is part; that is an expense line item that is recurrent on our operating P&L and we periodically look at this to see if they are going up or down. Like I said they do not necessarily... The customers have until five years to enter a claim and so that is not necessarily a big tie to capacity or passenger numbers. So there is a lot of volatility there, sometimes it goes up sometimes it goes down. This quarter is one it was aligned and went up more significantly than the rest.

**Mr. Valerio:** just my last one - sorry for that - a follow-on on the oil price. I saw that in this quarter we had a high increase in jet fuel than the branch oil and in the previous quarter, 1Q and 2Q it was the opposite. What can we expect for the next quarter and next year?

**Mr. XXX:** the main thing is there is about a 45 day lag between any impact that you see on international jet fuel prices, as well as foreign exchange. The 45 is an average number because what happens is Petrobras, which is the sole supplier fuel to all the distributors here in Brazil, they have a fixed price for the full month and that price is somewhat tied to the behavior of jet fuel prices internationally as well as FX for the previous month.

So on average you have about 45 day lag so I think even in October we were still paying fairly high fuel prices, November will be a little bit better; but it will still be higher than what you see on your screen today and probably in December we will get the full benefit of the improvement that you have seen both on FX and on fuel, and then assuming that these international prices stay flat that is where our local jet fuel prices would stabilize as well - but like I said if it goes up or down there is always going to be this 45 day delay until we see the impact on average.

**Mr. XXX:** this delay helps us through it but... It goes down but we would rather it works out fine for us.

**Mr. Valerio:** perfect thank you very much.

**Operator:** our next question comes from Savi Syth with Raymond James.

**Ms. Savi Syth:** just a quick follow-up on CASK. I was wondering if you could give an update there and just with fuel price high is there any risk those subleased aircraft being returned?

**Mr. XXX:** no. The subleased aircraft we have a full commitment to the end of the lease term and so there is no risk on that.

**Mr. XXX:** 2023...

Ms. XXX: and I would say that CASK is performing very well. We look at what all the team over there has done and we are very excited about all the work they have done and the... better airline is going through a similar transformation, they are improving significantly the product, getting new aircraft and have opened up a lot of new destinations for those of you in the US, for those of you in Europe, go through the gateway in Lisbon. It is an unbelievable city and one thing that we are finding Savi is that Lisbon is a kind of the new Miami for Brazilians and so it is a hotspot for Brazilians and it is actually a very, very cool city the guys in TAP are running and they are doing fantastic job - and TAP is doing great in Brazil and Azul is doing great in Portugal. Probably our most profitable international flight goes to Lisbon and Portugal is just hot right now. It is hard for people going to the US that used to flock around the streets and say hey, has anyone ever been to Portugal? And people would say no; but it seems like a great place and now it seems like everyone is going to Portugal and TAP has really benefited from the euphoria over Portugal right now. It is a great place to know and if you have not been there you are missing out.

**Ms. Syth:** thanks.

**Mr. XXX:** being at a significant position in Azul will get you a good fare as well.

**Operator:** next question from Dan McKenzie, Buckingham Research.

**Mr. Dan McKenzie:** thanks for the follow-up. Just one quick question regarding 2019. At this point how are you thinking about foreign exchange for purposes of internal planning? Are you thinking that the BRL might appreciate from here or... Maybe you could provide some perspective about it. There is a lot of moving pieces here and I was just wondering how are you thinking about things at this point?

**Mr. XXX:** Dan were in the middle of our... We are finalizing our budget right now. Normally we use the Focus Survey as well as the forward curve as a kind of guidelines to determine what kind of FX we are going to expect for next year. Between now and when we actually publish our guidance obviously we will again see where foreign exchange rates level out, as well as how confidence with the new government also materializes. So between now and then I think we will have a better gauge on where FX is going to level off. But it is normally very close to where both the Focus Survey, which is the collection of market players here in

Brazil, opinion on FX as well as the forward curve, and that is normally where you can assume is the rates that we use for our planning purposes as well as our guidance.

**Mr. XXX:** Dan when we use the budget we typically use a higher FX to challenge our people internally to work to be honest with you...

**Mr. XXX:** do not tell them...

**Mr. XXX:** it will trade between 3.50 and 3.70 next year. So I think that is where most people are kind of planning.

**Mr. XXX:** the big... Here in Brazil if you can get it done is obviously pension reform and there is a lot of talk about maybe - I am not putting the odds on it, it could be very difficult - but even getting it done with the current Congress, the current president can give it a fresh start as of January 1 and maybe getting something passed and obviously that will set the exchange will be able to get a significant pension reform done and we would fully expect everyone to strengthen the BRL from where it is today.

**Mr. McKenzie:** right and my condolences to all employees there. One follow-up question here... The Brazilian post office is there a sense of timing when you might have more perspective about when the economic benefits might begin to manifest itself with the JV with the post office?

**Mr. XXX:** you know Dan I think as we go through the budget process now you will probably start to see something of our 2019 forecast forward. We are certainly not... We will not see any benefits this year and it is most likely a 2Q 19 story as we move forward, as we sit down with the new administration and make sure that they are on board with the negotiated deal that we did with the previous administration at the Correios - but all things indicate that they are and more jointly working with the antitrust authority - CADE in Brazil currently, so it is really a 2019 story.

**Mr. McKenzie:** thanks for the time again guys.

**Mr. XXX:** thank you.

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

Ladies and gentlemen this concludes today's question-and-answer session. I would like to invite John to proceed with his closing statements. Please go ahead sir.

**Mr. XXX:** thank you for joining the call today and as always feel free to follow-up with Andrea, myself, Alex, Abhi and any members of our team and we look forward to seeing you at the conference is over the next couple of weeks and giving you more details about Azul. Thanks everybody for your support.

**Mr. XXX:** see you next quarter.

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

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