

***Consolidated Financial Statements***  
***Azul S.A.***  
***2019***



## Consolidated financial statements

December 31, 2019, 2018 and 2017

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### Consolidated financial statements

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## Management Comments

Thanks to the dedication of our Crewmembers, we delivered another year of outstanding results. As we go into a period of significant uncertainty following the outbreak of Covid-19 virus, it is reassuring to note that in 2019 we were the fastest growing and most profitable airline in Brazil, while always prioritizing our high customer experience standards.

Our top line grew 26% in 2019, reaching R\$11.4 billion, and adjusted EBITDA was R\$3.6 billion, 34% higher than in 2018. Adjusted operating income was R\$2.0 billion, representing a margin of 17.8%, in line with our market guidance, and 2.1 percentage points higher than in 2018. Adjusted net income for the period totaled R\$1.2 billion, compared to R\$896.6 million in the previous year.

In 2019 passenger demand grew at a healthy 24% led by the strength of our network, a more positive macroeconomic scenario and consolidation in the Brazilian airline sector. As a result, we increased unit revenue by 3.4%, while simultaneously growing 22% in terms of capacity year over year. Unit cost, or CASK, increased 0.8% over the year, excluding the impact of the end of the payroll tax relief, CASK would have decreased 1.9% in 2019.

As promised, we maintained our operating margin expansion together with a solid growth strategy. We continue transforming our fleet, and in 2019 we added 26 next-generation aircraft to our network, ending the year with 47 next-generation aircraft, representing 42% of our annual capacity. By 2022 we expect our entire narrowbody fleet will be next-generation, resulting in significant cost savings and reduction in fuel consumption, years ahead of our competition. Our fleet transformation plan is in line with our commitment to become an increasingly efficient and sustainable airline, engaged in mitigating climate change and promoting economic development by connecting local communities.

Our new aircraft have enabled us to strengthen our network, encouraging more and more people to access the 116 destinations we serve, eight of which were added to the network in 2019. We are the leading airline in 83% of our 249 routes, and are therefore proud to see Azul's role in connecting and promoting local development, taking Brazilians wherever they need to go and providing growth opportunities for several regions of Brazil, which until our arrival were not easily accessible.

Another important factor that contributes to healthy margins and a solid balance sheet is the great synergy between our business units. TudoAzul, our wholly-owned loyalty program, had a 31% increase in gross billings compared to the previous year, totaling 12 million members at the end of the year. In 4Q19, gross billings increased 41% year over year.

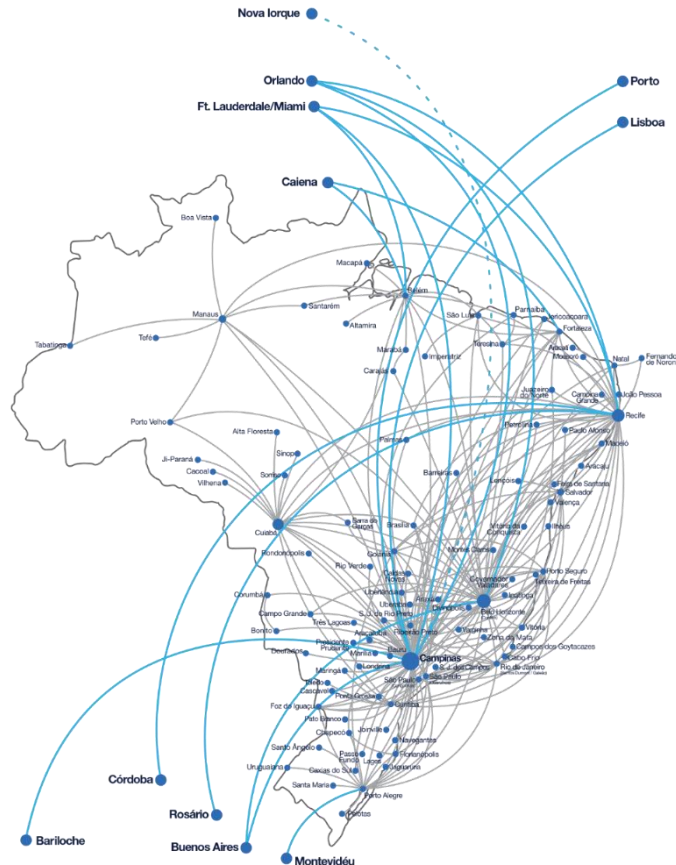
At the same time, Azul Cargo Express had an excellent performance and reached revenue growth of 45% compared to 2018, driven by the increase in cargo volume and our expanding presence in e-commerce. We ended 2019 with a 23% share of cargo volume transported in Brazil, the second highest in the country, underlining the importance of our unique network and the capillarity support it provides. Azul's exceptional customer service was recognized by the public. In addition to recording an average Net Promoter Score of 57 in 2019, we received six awards by TripAdvisor Travelers' Choice Awards, including one of the Top 10 Best Airlines in the world and Best Airline in Latin America. We also won the award for best customer service team in South America by Skytrax for the fourth time, and, for the ninth consecutive year, the site's users also ranked us best regional airline.

Over the coming years, we will maintain our margin expansion plan and healthy growth pace across all our business segments. For 2020, we are closely monitoring the impact of Covid-19 on the Brazilian economy and are preparing ourselves to react as swiftly as needed. We are no strangers to short-term challenges and remain confident in our long-term targets, proud of our Crewmembers and delighted to serve our customers while delivering great results to our shareholders.

**John Rodgerson, CEO of Azul S.A.**

## Azul in 2019

- ✓ 916 daily flights to 116 destinations
- ✓ 36% of domestic departures and 24% market share (RPK)
- ✓ Operating fleet of 142 aircraft with an average age of 5.8 years consisting of 59 E-Jets, 38 A320neos, 33 ATRs, 10 A330s, and 2 B737 freighter aircraft



## Macroeconomic Outlook

During 2019 the Brazilian economy continued to recover with GDP growing 1.1% in the year. Low inflation rates enabled the reduction of the country's risk-free rate (SELIC) to 4.5% in December, the lowest level in Brazil's history. The average unemployment rate fell from 12.3% in 2018 to 11.5% at the end of 2019, with the year-end Brazilian real appreciating slightly by 4.0% closing at 4.03 R\$/US\$ at December 31, 2019. The price of West Texas Instrument (WTI) crude oil accumulated gains of 34% over the previous year, reaching US\$ 61.06 per barrel by the end of the year, while the average price throughout the year decreased 11.2%.

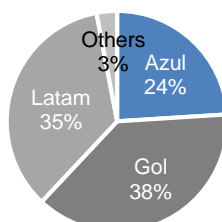
## Aviation market

In 2019, the Brazilian aviation market was marked by the exit of Avianca Brasil, the fourth largest carrier in the country, resulting in an industry capacity decrease of 1.0% year over year in terms of ASKs, and a slight growth in demand of 0.8% in terms of RPKs. The industry's average load factor totaled 82.7%, 1.7 percentage points higher compared to 2018.

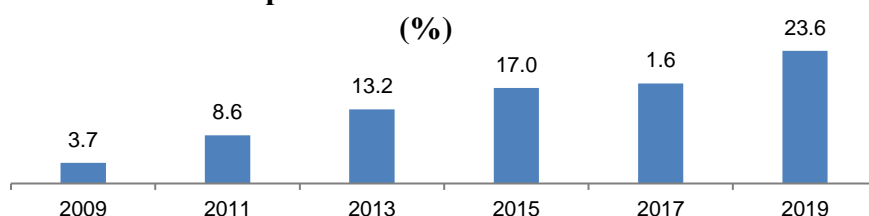
Azul recorded an RPK growth of 23.9% on an ASK growth of 22.2%, resulting in a load factor of 83.5%, 1.2 percentage points higher than in 2018. In 2019, Azul's RPK share reached 24%.

In addition to the change in competitive dynamics, the aviation sector was also impacted by the end of the payroll tax relief program in the beginning of 2019. Under the program, airlines had the option to pay 1.5% on gross revenue instead of 20% payroll tax.

**Market Share (RPK, 2019)**



**Azul's Participation in the Domestic Market RPK**



Since its foundation, the Company has built a resilient business model so that it can sustain itself under adverse macroeconomic scenarios. Our growth strategy, following our plan of continually replacing older, smaller aircraft with larger, more fuel-efficient next-generation aircraft, allows us to expand margins while growing our business. At the same time, our unique network, in which we are the only carrier in 70% of the routes we fly, provides us with a structural advantage, allowing us to react quickly under adverse macroeconomic conditions. As we replace our fleet with larger, more fuel-efficient aircraft we also expect to continue to grow our business units, including TudoAzul, Azul Cargo, and Azul Viagens.

## Environmental, Social and Governance (“ESG”) Responsibility

The table below presents Azul’s key ESG information, according to the Sustainability Accounting Standards Board (SASB) standard for the airline industry.

ESG KEY INDICATORS	2019	2018	% Δ
<b>Environmental</b>			
<b>Fuel</b>			
Total fuel consumed per ASK (GJ / ASK, million)	1,260.6	1,325.5	-4.9%
Total fuel consumed (GJ x 1000)	45,216	38,908	16.2%
<b>Fleet</b>			
Average age of operating fleet	5.8	5.9	-0.9%
<b>Social</b>			
<b>Labor Relations</b>			
Employee gender: (%) male	59.0	58.0	1.7%
(%) female	41.0	42.0	-2.4%
Employee monthly turnover (%)	1.2	1.0	26.3%
% of employee covered under collective bargaining agreements	100	100	0.0%
Number and duration of strikes and lockout (# days)	0	0	n.a.
Volunteers	2,193	1,914	14.6%
<b>Customer &amp; Company Behavior</b>			
Amount of legal and regulatory fines and settlements associated with anti-competitive practices	0	0	n.a.
<b>Safety</b>			
Number of accidents	0	0	n.a.
Number of governmental enforcement actions and aviation safety	0	0	n.a.
<b>Governance</b>			
<b>Management</b>			
Independent directors (%)	82.0	82.0	0.0%
Percent of board members that are women	9.0	9.0	0.0%
Board of directors average age	57.1	56.1	1.8%
Director meeting attendance (%)	87.9	99.0	-11.2%
Board size	11	11	0.0%
Participation of woman in leadership positions (%)	39.4	32.0	23.1%



## Consolidated Results

The following revised income statement and operating data should be read in conjunction with the annual results comments presented below. Prior periods have been restated to reflect adoption of the new IFRS 16 accounting standards.

Income statement (R\$ million)	2019 <sup>1</sup>	2018 <sup>2</sup>	% Δ
<b>OPERATING REVENUES</b>			
Passenger	10,907.9	8,670.1	25.8%
Cargo and other revenues	534.4	386.9	38.1%
<b>Total operating revenues</b>	<b>11,442.3</b>	<b>9,057.1</b>	<b>26.3%</b>
<b>OPERATING EXPENSES</b>			
Aircraft fuel	3,085.6	2,644.3	16.7%
Salaries, wages and benefits	1,868.4	1,413.0	32.2%
Depreciation and amortization	1,591.4	1,284.1	23.9%
Landing fees	725.0	592.1	22.4%
Traffic and customer servicing	476.5	395.4	20.5%
Sales and marketing	444.1	368.7	20.5%
Maintenance materials and repairs	281.6	238.5	18.1%
Other operating expenses	938.4	701.2	33.8%
<b>Total operating expenses</b>	<b>9,410.9</b>	<b>7,637.2</b>	<b>23.2%</b>
<b>Operating income</b>	<b>2,031.4</b>	<b>1,419.9</b>	<b>43.1%</b>
<i>Operating Margin</i>	<i>17.8%</i>	<i>15.7%</i>	<i>+2.1 p.p.</i>
<b>FINANCIAL RESULT</b>			
Financial income	72.1	74.5	-3.3%
Financial expenses	(1,329.5)	(1,094.8)	21.4%
Derivative financial instruments	325.5	298.1	9.2%
Foreign currency exchange, net	(391.9)	(1,306.1)	-70.0%
Result from related party transactions, net	(17.0)	381.7	n.a.
<b>Income before income taxes</b>	<b>690.6</b>	<b>(226.7)</b>	<b>n.a.</b>
Income tax and social contribution	(2.2)	(11.2)	-80.1%
Deferred income tax	135.4	(171.6)	n.a.
<b>Net income</b>	<b>823.7</b>	<b>(409.5)</b>	<b>n.a.</b>
<i>Net margin</i>	<i>7.2%</i>	<i>-4.5%</i>	<i>n.a.</i>
Fully diluted shares	343.0	342.8	0.0%
Diluted EPS	2.40	(1.19)	n.a.
Diluted EPADR	1.79	(0.92)	n.a.
Adjusted EPS <sup>3</sup>	3.54	2.62	35.5%
Adjusted EPADR <sup>3</sup>	2.63	2.03	29.9%

<sup>1</sup> 2019 adjusted for non-recurring items totaling R\$3.2 billion mostly due to an impairment charge associated with the sublease of EIs.

<sup>2</sup> 2018 adjusted for non-recurring items related to aircraft sale losses totaling R\$226.3 million.

<sup>3</sup> One ADS equals three preferred shares (PN).

The table below sets forth the breakdown of our operating revenues and expenses on a per ASK basis for the periods indicated:

R\$ cents	2019 <sup>1</sup>	2018 <sup>2</sup>	% Δ
<b>Operating revenue per ASK</b>			
Passenger revenue	30.41	29.54	3.0%
Cargo and other revenues	1.49	1.32	13.0%
<b>Operating revenue (RASK)</b>	<b>31.90</b>	<b>30.86</b>	<b>3.4%</b>
<b>Operating expenses per ASK</b>			
Aircraft fuel	8.60	9.01	-4.5%
Salaries, wages and benefits	5.21	4.81	8.2%
Depreciation and amortization	4.44	4.37	1.4%
Landing fees	2.02	2.02	0.2%
Traffic and customer servicing	1.33	1.35	-1.4%
Sales and marketing	1.24	1.26	-1.4%
Maintenance materials and repairs	0.78	0.81	-3.4%
Other operating expenses	2.62	2.39	9.5%
<b>Total operating expenses (CASK)</b>	<b>26.24</b>	<b>26.02</b>	<b>0.8%</b>
<b>Operating income per ASK (RASK - CASK)</b>	<b>5.66</b>	<b>4.84</b>	<b>17.1%</b>

<sup>1</sup> 2019 adjusted for non-recurring items totaling R\$3.2 billion mostly due to an impairment charge associated with the sublease of E1s.

<sup>2</sup> 2018 adjusted for non-recurring items related to aircraft sale losses totaling R\$226.3 million.

Operating Data	2019 <sup>1</sup>	2018 <sup>2</sup>	% Δ
ASKs (million)	35,868	29,353	22.2%
RPKs (million)	29,941	24,156	23.9%
Load factor (%)	83.5%	82.3%	+1.2 p.p.
Average fare (R\$)	394.2	375.0	5.1%
Revenue passengers (thousands)	27,674	23,122	19.7%
Block hours	495,362	433,945	14.2%
Departures	295,354	262,312	12.6%
Average stage length (km)	1,050	1,006	4.3%
Yield per passenger kilometer (cents)	36.43	35.89	1.5%
RASK (cents)	31.90	30.86	3.4%
PRASK (cents)	30.41	29.54	3.0%
CASK (cents)	26.24	26.02	0.8%
CASK ex-fuel (cents)	17.63	17.01	3.7%

<sup>1</sup> 2019 adjusted for non-recurring items totaling R\$3.2 billion mostly due to an impairment charge associated with the sublease of E1s.

<sup>2</sup> 2018 adjusted for non-recurring items related to aircraft sale losses totaling R\$226.3 million.



### Operating Revenue:

Operating revenue increased 26.3%, or R\$2.4 billion, from R\$9.1 billion in 2018 to R\$11.4 billion in 2019, due to (i) an increase of 25.8% of passenger revenue and (ii) a 38.1% increase in cargo and other revenue.

The R\$2.2 billion, or 25.8% increase in passenger revenues in 2019 compared to 2018 was mainly attributable to (i) an increase of 23.9% of RPKs reflecting a 22.2% increase in ASK's and (ii) a 3.0% increase in PRASK due to higher load factors, yields and non-ticket revenue.

The R\$147.5 million or 38.1% increase in cargo and other revenue was mainly due to a 45% increase in cargo revenue.

### Operating Expenses

Operating expenses, excluding the impact of non-recurrent items totaling R\$3.2 billion mostly related to the impairment charge of our fleet transformation (see exhibit A), increased 23.2%, or R\$1.8 billion, from R\$7.6 billion in 2018 to R\$9.4 billion in 2019 mainly due to:

- An increase in fuel expenses of 16.7% or R\$441.3 million in 2019 compared to 2018, mainly as a result of (i) a 14.2% increase in block hours and (ii) the 0.4% increase in fuel price per liter, partially offset by the introduction of more fuel-efficient aircraft to our fleet. On a per-ASK basis, aircraft fuel decreased by 4.5%.
- An increase in salaries, wages, and benefits of 32.2% or R\$455.4 million in 2019 compared to 2018, due to (i) an increase in the number of crewmembers from 11,807 in 2018 to 13,189 in 2019, mostly related to the 22% increase in capacity and (ii) the end of a 20% payroll tax relief effective since January 2019. On a per ASK basis, salaries, wages and benefits increased 8.2%.
- Depreciation and amortization increased 23.9% or R\$307.3 million, mainly due to a net addition of 23 aircraft to the fleet during 2019 and an increase in the capitalization of heavy maintenance checks. On a per-ASK basis, depreciation and amortization increased 1.4%.
- Landing fees increased 22.4% or R\$132.9 million in 2019 compared to 2018 primarily due to the 22.2% increase in ASKs. On a per ASK basis, landing fees increased 0.2%.
- Maintenance, materials and repairs increased 18.1% or R\$43.1 million in 2019 compared to 2018 primarily due to a higher number of aircraft in our fleet resulting in an increase in maintenance repair and overhaul fee rates. On a per ASK basis, maintenance decreased 3.4%.
- Other operating expenses excluding the R\$226.3 million loss related to the sale of six E-jets incurred in 2Q18 increased 33.8% or R\$237.2 million in the year ended December 31, 2019 compared to 2018 primarily due to (i) an increase in training and accommodations expenses related to our growth, (ii) higher IT expenses, and (iii) an increase in flight contingencies. On a per-ASK basis, other operating expenses increased 9.5%.

## Liquidity and Financing

Azul closed the year with R\$4.3 billion in cash, cash equivalents, short-term and long-term investments, and receivables, 5.7% above the R\$4.0 billion recorded in 2018, representing 37.3% of its last twelve months' revenue. The company has no restricted cash and also held maintenance reserves totaling R\$1.7 billion as of December 31, 2019, which are not included in its cash position.

Liquidity (R\$ million)	2019	2018	% Δ
Cash <sup>1</sup>	3,107.6	2,974.3	4.5%
Accounts receivable	1,165.9	1,069.1	9.1%
<b>Total Liquidity</b>	<b>4,273.5</b>	<b>4,043.4</b>	<b>5.7%</b>
<i>Liquidity as % of LTM adjusted revenues</i>	<i>37.3%</i>	<i>44.6%</i>	<i>-7.3 p.p.</i>

<sup>1</sup> Includes cash and cash equivalents and short-term and long-term investments.

Total debt adjusted for currency hedges increased 35.7% to R\$15.0 billion compared to December 31, 2018, mostly due to the net addition of 23 new aircraft during the period.

Azul's leverage ratio measured as net debt to EBITDA was 3.3x. Excluding the debt related to the 13 aircraft received in 4Q19, which did not generate EBITDA for the full quarter, leverage would have been 2.7x. As of December 31, 2019, Azul's average debt maturity excluding lease liabilities was 3.4 years with an average interest rate of 5.0%. Local and dollar-denominated obligations average interest rate was 4.8% and 5.5%, respectively. Additionally, considering currency swap agreements, 100% of the Company's non-aircraft debt was denominated in Brazilian reais at the end of the quarter.

Loans and financing (R\$ million) <sup>1</sup>	2019	2018	% Δ
Operating lease liabilities	11,118.4	7,805.0	42.5%
Finance lease liabilities	988.3	1,114.7	-11.3%
Sublease receivables	(279.5)	(361.7)	-22.7%
Other aircraft loans and financing	1,060.5	292.9	262.1%
<b>Loans and financing</b>	<b>2,457.6</b>	<b>2,463.2</b>	<b>-0.2%</b>
Currency hedges	(321.7)	(240.4)	33.8%
<i>% of non-aircraft debt in local currency</i>	<i>100%</i>	<i>100%</i>	<i>+0.0 p.p.</i>
<b>Gross debt</b>	<b>15,023.5</b>	<b>11,073.7</b>	<b>35.7%</b>
<i>Short term</i>	<i>1,970.7</i>	<i>1,323.1</i>	<i>48.9%</i>
<i>Long term</i>	<i>13,052.9</i>	<i>9,750.7</i>	<i>33.9%</i>

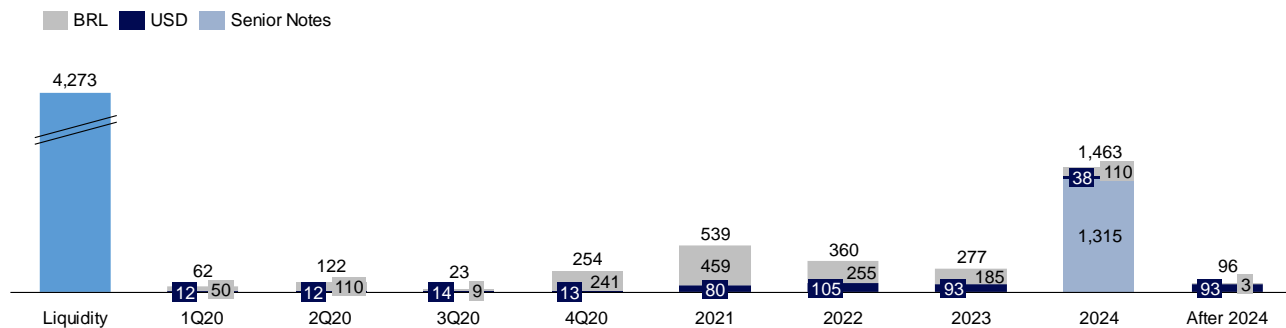
<sup>1</sup> Considers the effect of currency hedges on debt.

Azul's key financial ratios and debt maturity are presented below:

Key financial ratios (R\$ million)	2019	2018	% Δ
Cash <sup>1</sup>	3,107.6	2,974.3	4.5%
Gross debt	15,023.5	11,073.7	35.7%
Net debt	11,915.9	8,099.4	47.1%
Net debt / EBITDA (LTM)	3.3	3.0	9.8%

<sup>1</sup> Includes cash and cash equivalents and short-term and long-term investments.

### Debt Maturity\* 4Q19 (R\$ million)



\*Adjusted for currency swaps

## Fleet

As of December 31, 2019, Azul had a total operating fleet of 142 aircraft with an average age of 5.8 years. The Company's contractual fleet totaled 166 aircraft, of which 19 were under finance leases and 147 under operating leases. The 24 aircraft not included in our operating fleet consisted of 15 aircraft subleased to TAP, six aircraft being prepared to exit the fleet and three A320neo family aircraft in process of entering service.

### Total Contractual Fleet

Aircraft	Number of seats	2019	2018	% Δ
A330	242-271	8	7	14.3%
A330neo	298	2	-	n.a.
A320neo Family	174-214	41	20	105.0%
E195-E2	136	4	-	n.a.
E-Jets	106-118	70	72	-2.8%
ATRs	70	39	42	-7.1%
B737 Freighter	-	2	2	0.0%
<b>Total<sup>1</sup></b>		<b>166</b>	<b>143</b>	<b>16.1%</b>
<i>Aircraft under operating leases</i>		<i>147</i>	<i>123</i>	<i>19.5%</i>

<sup>1</sup> Includes aircraft subleased to TAP

### Total Operating Fleet

Aircraft	Number of seats	2019	2018	% Δ
A330	242-271	8	7	14.3%
A330neo	298	2	-	n.a.
A320neo Family	174-214	38	20	90.0%
E195-E2	136	4	-	n.a.
E-Jets	106-118	55	63	-12.7%
ATRs	70	33	33	0.0%
B737 Freighter	-	2	2	0.0%
<b>Total</b>		<b>142</b>	<b>125</b>	<b>13.6%</b>

## Exhibit A

### Non-Recurring Items Reconciliation

Our IFRS results include the impacts of charges that are deemed non-recurring items, which we believe, make our results difficult to compare to prior periods as well as future periods and guidance. In 4Q19 we recognized R\$3.2 billion of non-recurring items consisted of an impairment charge related to the difference between the book value and expected recoverable amount of our E1s, the write-off of E1 inventory and spare parts, expected aircraft sale losses, delivery expenses, and contractual early termination fees.

The table below provides a reconciliation of our IFRS reported amounts to the non-IFRS amounts excluding non-recurrent items. For more information on the impairment charge see note 1 in our financial statements.

2019 Non-recurring adjustments	As recorded	Adjustment	Adjusted
<b>Operating expenses</b>	<b>12,637.7</b>	<b>(3,226.8)</b>	<b>9,410.9</b>
Aircraft fuel	3,085.6	-	3,085.6
Salaries, wages and benefits	1,868.4	-	1,868.4
Depreciation and amortization	3,670.9	(2,079.5)	1,591.4
Landing fees	725.0	-	725.0
Traffic and customer servicing	476.5	-	476.5
Sales and marketing	444.1	-	444.1
Maintenance materials and repairs	354.1	(72.5)	281.6
Other operating expenses	2,013.2	(1,074.8)	938.4
<b>Operating income</b>	<b>(1,195.4)</b>	<b>3,226.8</b>	<b>2,031.4</b>
EBITDA	2,475.5	1,147.3	3,622.8
<b>Net income</b>	<b>(2,403.1)</b>	<b>3,226.8</b>	<b>823.7</b>
Basic net income per PN share (R\$)	(7.01)	9.41	2.40
<b>Diluted net income per PN share (R\$)</b>	<b>(5.21)</b>	<b>7.00</b>	<b>1.79</b>

## **Declaration of the officers on the financial statements**

In compliance with CVM Instruction No. 480/09, the Executive officers declare that they have discussed, reviewed and approved the financial statements for the year ended December 31, 2019.

São Paulo, March 09, 2020.

John Peter Rodgerson  
President and Chief Executive Officer

Alexandre Wagner Malfitani  
Executive Vice President and Chief Financial Officer



## **Declaration of the officers on the independent auditors report on the financial statements**

In compliance with CVM Instruction No. 480/09, the Executive officers declare that they have discussed, reviewed and approved the conclusions expressed in the independent auditors report on the individual and consolidated financial statements for the year ended December 31, 2019.

São Paulo, March 09, 2020.

John Peter Rodgerson  
President and Chief Executive Officer

Alexandre Wagner Malfitani  
Executive Vice President and Chief Financial Officer

## **Summary report of the audit committee**

The members of the Audit Committee, considering the documents presented and the information and clarifications provided by the Company's Board of Executive Officers and by Ernst & Young Auditores Independentes SS during the year, Management Report and the individual and consolidated Financial Statements (including explanatory notes) for the fiscal year ended December 31, 2019, together with an opinion to be issued by Ernst & Young Auditores Independentes SS, recommending to the Board of Directors its approval.

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Gilberto de Almeida Peralta  
Member of the Audit Committee

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Sergio Eraldo de Salles Pinto  
Member of the Audit Committee

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Gelson Pizzirani  
Member of the Audit Committee

**A free translation from Portuguese into English of Independent Auditor's Report on financial statements prepared in accordance with the accounting practices adopted in Brazil and International Financial Reporting Standards (IFRS)**

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**INDEPENDENT AUDITOR'S REPORT ON INDIVIDUAL AND CONSOLIDATED FINANCIAL STATEMENTS**

The Management and Shareholders of Azul S.A.

**Opinion**

We have audited the individual and consolidated financial statements of Azul S.A. ("the Company"), identified as Parent Company and Consolidated, respectively, which comprise the balance sheet as of December 31, 2019 and the statements of income, of comprehensive income, of statement of changes in equity, and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements referred to above present fairly, in all material respects, the individual and consolidated financial position of Azul S.A. as at December 31, 2019, its individual and consolidated financial performance and its individual and consolidated cash flows for the year then ended, in accordance with accounting practices adopted in Brazil and International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB).

**Basis for opinion**

We conducted our audit in accordance with Brazilian and International Standards on Auditing. Our responsibilities, under those standards, are further described in the "Auditor's responsibilities for the audit of the individual and consolidated financial statements" section of our report. We are independent of the Company and its subsidiaries and comply with the relevant ethical principles set forth in the Code of Professional Ethics for Accountants, the professional standards issued by the Brazil's National Association of State Boards of Accountancy (CFC) and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to support our opinion.

**Emphasis of matter on the restatement of corresponding figures**

As mentioned in note 3.19, in connection with the adoption of CPC 06 (R2) – Leases equivalent to IFRS 16, the amounts corresponding to the years 2018 and 2017, presented for comparison purposes, were adjusted and are being presented as provided for in Accounting Pronouncement NBC TG 23 (R1) – Accounting Policies, Change of Error Correction and Estimation. Our opinion has not been modified with respect to this matter.

## **Key audit matters**

Key audit matters are those matters that, in our professional judgment, were the most significant in our audit of the financial statements of the current year. Those matters were addressed in the context of our audit of the overall individual and consolidated financial statements, and to form our opinion on these individual and consolidated financial statements. Therefore, we do not express a separate opinion on those matters. The presentation of the matters below, including any description of our procedures to address the matter and any findings resulting from our procedures is presented in the context of the financial statements as a whole.

We have fulfilled the responsibilities described in the “Auditor’s responsibilities for the audit of the individual and consolidated financial statements” section of our report, including our responsibilities with respect to these key audit matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying financial statements.

Passenger Revenue

Flight revenue is recognized upon effective rendering of the transportation service. Tickets sold and not used, corresponding to advanced ticket sales (air traffic liability), are recorded in current liabilities and are recognized when used, on an accrual basis. The recognition of certain revenues takes into account estimates with a high degree of professional judgment by management, such as the expectation of expiration of unused tickets, these assumptions are evaluated by management based on historical data. Additionally, the process of ticket sales and flight revenue recognition is highly dependent on information technology (IT) systems.

Considering the facts listed above and the magnitude of these balances on the financial statements as a whole, we consider this a key audit matter.

### *How our audit addressed this matter*

The audit procedures included, among others (i) the analysis of the adequacy of manual journal entries included in the revenue accounts; (ii) comparison of a sample of flights with reports issued by the aviation regulatory agency; (iii) observation of a sample of passenger boarding the airplanes in order to verify the respective revenue; (iv) analytical review of revenue balances considering our expectations and market indicators; and (v) analysis of revenue recognition over expired credits (breakage); and (vi) evaluation of financial statements disclosures, included in notes 3.16 and 25, were appropriate.

Based on the results of the audit procedures performed, which is consistent with management's assessment, we consider the Company's passenger revenue recognition policies are acceptable to support the judgments, estimates and information included in the financial statements taken as a whole.

### Bonds Convertible in TAP shares

On March 14, 2016, the Company acquired series A convertible bonds issued by TAP (the “TAP Convertible Bonds”) for an amount of €90 million. The TAP Convertible Bonds are convertible, in whole or in part at, the option of Azul into new shares representing the share capital of TAP benefiting from enhanced preferential economic rights (the “TAP Shares”). Upon full conversion, the TAP Shares will represent 6.0% of the total and voting capital of TAP, with the right to receive dividends or other distributions corresponding to 41.25% of distributable profits of TAP, as disclosed in footnote 12(h)(ii). The fair value of the option was classified as a single financial asset recorded at changes in the fair value through profit or loss, under “Result from related parties transactions, net”, classified in “Long term investments” as disclosed in footnote 12(h)(ii).

The above matter was considered a key audit matter, due to the relevance of the amounts and the required judgment, exercised by management in the calculation of the fair value.  
How our audit addressed this matter

Our auditing procedures included, among others, (i) reviewing the assumptions for the fair value calculation prepared by management of the non-current financial asset (Bond TAP) including the involvement of our Valuation professionals to assist us in the execution of procedures; (ii) the evaluation of the adequacy of the accounting records related to the operation; and (iii) the evaluation whether the disclosures in the financial statements, included in the footnotes 12(h)(ii) and 24, were appropriate.

Based on the results of the audit procedures performed, which is consistent with management's assessment, we consider acceptable the fair value measurement policies of the non-current financial asset (Bond TAP) to support the judgments, estimates and information included in the context of the financial statements taken as a whole.

### Maintenance reserves

Under the terms of lease agreements with aircraft lessors formerly classified as “operating”, the Company is contractually committed to maintain or reimburse the lessor based on the actual condition of the airframe, engines and life limited parts.

The recoverability of these deposits is assessed by management through a comparison of the amounts that are expected to be reimbursed at the time of the next maintenance event. Amounts determined as non-recoverable are recognized as expenses in the income statement of income. As of December 31, 2019, as disclosed in the footnote 13, the balance of maintenance reserves totaled R\$1.4 billion.

Considering the magnitude of the amounts involved, in addition to the degree of judgment applied in determining the maintenance cost estimates to be incurred and the need for management to monitor the recoverability of these deposits, we consider this a key audit matter.

#### *How our audit addressed this matter*

The audit procedures included, among others, (i) sending confirmation letter to the lessors in order to confirm the balance of the maintenance reserve for each individual contract; (ii) analysis of the recoverability of the maintenance reserve, prepared by management, which considers the recoverability of each deposit for each aircraft item and lessor; (iii) evaluation of financial statements disclosures included in notes in Notes 3.11b and 13, were appropriated.

Based on the results of our audit procedures, which is consistent with management's assessment, we consider acceptable the maintenance reserve measurement policies to support the judgments, estimates and information included in the financial statements.

#### Leasing

As disclosed in Notes 3.7.1, 3.19 and 14 of the financial statements as at December 31, 2019, on January 1, 2019, the Company adopted the new accounting pronouncement CPC 06 (R2) – Leases equivalent to IFRS 16 - Leases issued by International Accounting Standards Board - IASB, applying the full retrospective approach. Consequently, previous periods were restated and the accumulated effect of the initial adoption on January 1, 2017 was recorded in the accumulated losses in equity. This new Standard adoption resulted in the recognition of right of use (asset), lease liability and accumulated loss in the balance sheets as at January 1, 2017, among other impacts, according to Notes 3.19 and 14.

We considered the adoption of CPC 06 (R2) – Leases equivalent to IFRS 16, as a significant matter for our audit because of significant amounts, impact in the accounting accounts and judgment involved by management in the determination of the discount rate of the leasing contracts, which is a key judgement to estimate the right of use of the asset and lease liability.

#### *How our audit addressed this matter*

Our audit procedures included, among others (i) understanding and review of assumptions, controls, accounting policy and methodology defined for the adoption of the new pronouncement; (ii) execution of procedures to validate the integrity of the list of leases considered by the Company; (iii) selecting a sample of transactions and obtaining the contracts and data necessary to recalculate the right of use of the asset and lease liabilities for such operations; (iv) recalculation of the discount rate used by the Company; (v) assessing whether the disclosures in the financial statements, included in Notes 3.7.1, 3.19 and 14, were appropriate based on the current accounting standards.

Based on the result of the audit procedures performed, which is consistent with management's assessment, we consider the recognition and measurement policies, as well as the respective disclosures, regarding the adoption of CPC 06 (R2) equivalent to IFRS16 to be acceptable in the context of the financial statements taken as a whole.



### Impairment – aircrafts Embraer E195

As detailed in Note 1, in the year ended December 31, 2019, the Company recorded an impairment loss in the amount of R\$2,032,307 thousand related to aircrafts Embraer E195 which will be replaced by a more modern fleet and are being subject to sublease arrangements to other airlines, apart from a provision for onerous contracts in the amount of R\$ 797,591 thousand. The methodology and technique used to determine the recoverable value of those assets were based on the discounted cash flow of each aircraft, for which assumptions were made by management that involved a high degree of judgement, mainly with respect to inflow and outflow of future cash and discount rate. This matter was considered significant to our audit given the relevance of the amounts involved, uncertainties inherent to the estimate of recoverable value, given the use by management of judgment in the assumptions behind its calculation. A change to one of these assumptions may give rise to a significant impact to Company's financial statements.

#### *How our audit addressed this matter*

Our audit procedures included, among others, the analysis and review of methodologies and techniques used by management, the assessment of assumptions which supported the cash projections of the aircrafts, including the review of sublease contracts and projected costs. Our procedures also included the involvement of valuation specialists on the review of reasonableness and consistency of data and the assumptions utilized in the determination of recoverable value, including discount rate, the controls and procedures adopted by management in the cash flow estimates; we also analyzed the mathematical accuracy. As a result of these procedures, we identified adjustment in the calculations deriving from certain inconsistencies, which was deemed to be immaterial to the financial statements taken as a whole.

Based upon the results of the audit procedures performed on the recoverable value of the mentioned aircrafts, consistent with management's assessment, we consider that the policies and assumptions with respect to the recoverable value, as well as the notes, are acceptable in the context of financial statements taken as a whole.

### Other matters

#### Statements of value added

The individual and consolidated statements of value added for the year ended December 31, 2019, prepared under the responsibility of the Company's Management and presented as supplementary information under IFRS, were submitted to the same audit procedures performed in accordance with the audit of the Company's financial statements. For the purposes of forming our opinion, we evaluated whether these statements are reconciled with the financial statements and accounting records, as applicable, and whether their form and content are in accordance with the criteria provided for in Accounting Pronouncement CPC 9 - Statement of Value Added. In our opinion, these statements of value added were prepared fairly, in all material respects, in accordance with the criteria defined in Accounting Pronouncement CPC 9 and are consistent with the overall individual and consolidated financial statements as a whole.

Other information accompanying the individual and consolidated financial statements and the auditor's report

The Company's Management is responsible for other information that includes the Management Report. Our opinion on the individual and consolidated financial statements does not cover the Management Report and we do not express any form of audit conclusion on the Management Report. In connection with the audit of the individual and consolidated financial statements, our responsibility is to read the Management Report and, in doing so, consider whether this report is materially inconsistent with the financial statements or based on our knowledge obtained in the audit, or otherwise, whether this report appears to be materially misstated. If based on our work performed, we conclude that there is material misstatement in the Management Report, we are required to report this fact. We have nothing to report on this matter.

Responsibilities of Management and those charged with governance for the individual and consolidated financial statements

Management is responsible for the preparation and fair presentation of the individual and consolidated financial statements in accordance with the accounting practices adopted in Brazil and International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB), and for such internal control as Management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. In preparing the individual and consolidated financial statements, Management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless Management either intends to liquidate the Company and its subsidiaries or to cease operations, or has no realistic alternative but to do so. Those charged with governance of the Company and its subsidiaries are responsible for overseeing the financial reporting process.

Auditor's responsibilities for the audit of the individual and consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the individual and consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the Brazilian and International Standards on Auditing will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with the Brazilian and International Standards on Auditing, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the individual and consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the internal control of the Company and its subsidiaries.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by Management.
- Conclude on the appropriateness of Management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the ability of the Company and its subsidiaries to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the individual and consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company and its subsidiaries to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the individual and consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.



From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

São Paulo, March 12, 2020

ERNST & YOUNG  
Auditores Independentes S.S.  
CRC-2SP034519/O-6

Marcio D. Berstecher  
Accountant CRC-1SP259735/O-2

## Azul S.A.

Consolidated statements of financial position  
As of December 31, 2019, 2018 and 2017  
(In thousands of Brazilian reais)

	December 31,		
	2019	2018 (Restated)	2017 (Restated)
Assets			
Current assets			
Cash and cash equivalents (Note 6)	1,647,880	1,169,136	762,319
Short-term investments (Note 7)	62,009	517,423	1,036,148
Restricted investments	-	-	8,808
Trade and other receivables (Note 8)	1,165,866	1,069,056	914,428
Aircraft sublease receivables (Note 9)	75,052	73,671	57,768
Inventories (Note 10)	260,865	200,145	150,393
Assets held for sale (Note 14)	51,850	-	-
Security deposits and maintenance reserves (Note 13)	258,212	144,192	130,112
Taxes recoverable	139,668	283,841	112,891
Derivative financial instruments (Note 24)	168,148	6,654	10,345
Prepaid expenses (Note 11)	139,403	115,453	82,656
Other current assets	169,778	110,623	198,807
Total current assets	4,138,731	3,690,194	3,464,675
Non-current assets			
Long-term investments (Note 24)	1,397,699	1,287,781	835,957
Aircraft sublease receivables (Note 9)	204,452	288,067	308,824
Security deposits and maintenance reserves (Note 13)	1,393,321	1,402,528	1,129,015
Derivative financial instruments (Note 24)	657,776	588,726	410,477
Prepaid expenses (Note 11)	22,216	21,683	4,472
Taxes recoverable	244,601	-	-
Other non-current assets	497,567	397,398	169,816
Right-of-use – lease (Note 14)	7,087,412	4,926,326	4,377,725
Right-of-use – aircraft maintenance (Note 14)	497,391	632,900	374,384
Property and equipment (Note 14)	1,968,840	1,842,239	1,880,771
Intangible assets (Note 15)	1,087,484	1,016,556	961,000
Total non-current assets	15,058,759	12,404,204	10,452,441
Total assets	19,197,490	16,094,398	13,917,116

	December 31,		
	2019	2018 (Restated)	2017 (Restated)
Liabilities and equity			
Current liabilities			
Loans and financing (Note 17)	481,227	158,813	419,198
Lease liabilities (Note 18)	1,585,233	1,237,909	914,600
Accounts payable (Note 19)	1,376,850	1,287,661	971,750
Accounts payable – Supplier finance (Note 19)	249,727	162,778	-
Air traffic liability (Note 20)	2,094,254	1,672,452	1,287,434
Salaries, wages and benefits	357,571	244,008	246,336
Insurance premiums payable	49,938	34,999	24,411
Taxes payable	49,060	56,999	44,418
Federal tax installment payment program	13,480	9,749	9,772
Derivative financial instruments (Note 24)	81,196	180,975	48,522
Provisions (Note 21)	323,441	36,083	-
Other current liabilities	200,043	193,492	151,696
Total current liabilities	6,862,020	5,275,918	4,118,137
Non-current liabilities			
Loans and financing (Note 17)	3,036,929	2,597,313	2,159,241
Lease liabilities (Note 18)	10,521,388	7,681,837	6,428,893
Derivative financial instruments (Note 24)	228,994	260,019	378,415
Deferred income taxes (Note 16)	242,516	293,211	142,102
Federal tax installment payment program	119,300	95,705	105,431
Provisions (Note 21)	1,489,911	713,941	553,155
Other non-current liabilities	215,606	326,492	422,713
Total non-current liabilities	15,854,644	11,968,518	10,189,950
Equity			
Issued capital (Note 22)	2,243,215	2,209,415	2,163,377
Capital reserve	1,928,830	1,918,373	1,898,926
Treasury shares (Note 22)	(15,565)	(10,550)	(2,745)
Other comprehensive loss (Note 22)	(159,261)	(153,969)	(14,688)
Accumulated losses	(7,516,393)	(5,113,307)	(4,435,841)
	(3,519,174)	(1,150,038)	(390,971)
Total liabilities and equity	19,197,490	16,094,398	13,917,116

The accompanying notes are an integral part of these financial statements.



## Azul S.A.

### Consolidated statements of operations

Year ended December 31, 2019, 2018 and 2017

(In thousands of Brazilian reais, except income (loss) per share)

	Year ended December 31,		
	2019	2018 (Restated)	2017 (Restated)
Operating revenue (Note 25)			
Passenger revenue	10,907,889	8,670,132	6,695,340
Cargo and other revenue	534,428	386,932	1,009,491
Total revenue	11,442,317	9,057,064	7,704,831
Operating expenses			
Aircraft fuel	(3,085,603)	(2,644,261)	(1,848,195)
Salaries, wages and benefits	(1,868,402)	(1,413,017)	(1,296,166)
Landing fees	(724,971)	(592,100)	(490,569)
Traffic and customer servicing	(476,481)	(395,394)	(357,841)
Sales and marketing	(444,079)	(368,663)	(309,540)
Maintenance materials and repairs	(354,105)	(250,105)	(484,156)
Depreciation and amortization (*)	(3,670,884)	(1,284,050)	(1,063,378)
Other operating expenses, net (*)	(2,013,192)	(915,850)	(612,194)
	(12,637,717)	(7,863,440)	(6,462,039)
Operating income (loss)	(1,195,400)	1,193,624	1,242,792
Financial result (Note 26)			
Financial income	72,071	74,522	128,272
Financial expense	(1,329,524)	(1,094,828)	(1,078,598)
Derivative financial instruments, net	325,452	298,094	(90,171)
Foreign currency exchange, net	(391,905)	(1,306,063)	34,859
	(1,323,906)	(2,028,275)	(1,005,638)
Result from related parties transactions, net	(16,959)	381,725	176,975
Net income (loss) before income tax and social contribution	(2,536,265)	(452,926)	414,129
Income tax and social contribution (Note 16)	(2,228)	(11,224)	2,875
Deferred income tax and social contribution (Note 16)	135,407	(171,581)	7,509
Net income (loss)	(2,403,086)	(635,731)	424,513
Basic net income (loss) per common share - R\$ (Note 23)	(0.09)	(0.03)	0.02
Diluted net income (loss) per common share - R\$ (Note 23)	(0.09)	(0.03)	0.02
Basic net income (loss) per preferred share - R\$ (Note 23)	(7.05)	(1.88)	1.35
Diluted net income (loss) per preferred share - R\$ (Note 23)	(7.05)	(1.88)	1.32

(\*) Includes non recurring items consisting of impairment charge and one time costs related to the sublease of 53 E195 totalling R\$2,873,157 (Note 1).

The accompanying notes are an integral part of these financial statements.

## Azul S.A.

Consolidated statements of other comprehensive income  
Year ended December 31, 2019, 2018 and 2017  
(In thousands of Brazilian reais)

	December 31,		
	2019	2018	2017
		(Restated)	(Restated)
Net income (loss)	(2,403,086)	(635,731)	424,513
Other comprehensive income to be reclassified to profit or loss in subsequent periods:			
Changes in fair value of cash flow hedges, net of tax	(5,292)	(139,281)	31,309
Total comprehensive income (loss)	(2,408,378)	(775,012)	455,822

The accompanying notes are an integral part of these financial statements.

## Azul S.A.

### Consolidated statements of changes in equity Year ended December 31, 2019, 2018 and 2017 (In thousands of Brazilian reais)

	Issued capital	Capital Reserve	Treasury shares	Cash flow hedge reserve	Accumulated losses	Total
December 31, 2016	1,488,601	1,290,966	-	(33,785)	(1,743,795)	1,001,987
Impact of adoption of IFRS 16 (Note 3)	-	-	-	(12,212)	(3,116,559)	(3,128,771)
January 1, 2017	1,488,601	1,290,966	-	(45,997)	(4,860,354)	(2,126,784)
Profit for the period	-	-	-	-	424,513	424,513
Other comprehensive income	-	-	-	31,309	-	31,309
Total comprehensive income	-	-	-	31,309	424,513	455,822
Issued capital (Note 21)	661,500	646,479	-	-	-	1,307,979
Issuance of shares due exercise of stock options (Note 21)	13,276	4,623	-	-	-	17,899
Share issuance costs (Note 21)	-	(71,283)	-	-	-	(71,283)
Treasury shares, net (Note 21)	-	-	(2,745)	-	-	(2,745)
Share-based payment expense (Note 27)	-	28,141	-	-	-	28,141
December 31, 2017	2,163,377	1,898,926	(2,745)	(14,688)	(4,435,841)	(390,971)
Impact of adoption of IFRS 9 (*)	-	-	-	-	(416)	(416)
Impact of adoption of IFRS 15 (**)	-	-	-	-	(41,319)	(41,319)
January 1, 2018	2,163,377	1,898,926	(2,745)	(14,688)	(4,477,576)	(432,706)
Loss for the period	-	-	-	-	(635,731)	(635,731)
Other comprehensive income	-	-	-	(139,281)	-	(139,281)
Total comprehensive income	-	-	-	(139,281)	(635,731)	(775,012)
Issuance of shares due exercise of stock options (Note 22)	46,038	1,596	-	-	-	47,634
Treasury shares, net (Note 22)	-	-	(7,805)	-	-	(7,805)
Share-based payment expense (Note 28)	-	17,851	-	-	-	17,851
December 31, 2018	2,209,415	1,918,373	(10,550)	(153,969)	(5,113,307)	(1,150,038)
Loss for the period	-	-	-	-	(2,403,086)	(2,403,086)
Other comprehensive income	-	-	-	(5,292)	-	(5,292)
Total comprehensive income	-	-	-	(5,292)	(2,403,086)	(2,408,378)
Issuance of shares due exercise of stock options (Note 22)	33,800	3,967	-	-	-	37,767
Treasury shares, net (Note 22)	-	-	(5,015)	-	-	(5,015)
Share-based payment expense (Note 28)	-	6,490	-	-	-	6,490
December 31, 2019	2,243,215	1,928,830	(15,565)	(159,261)	(7,516,393)	(3,519,174)

(\*) The Company applied, for the first time, IFRS 9 in 2018, opting not to present comparative information showing retrospectively the results from the adoption of IFRS 9.

(\*\*) The Company applied IFRS 15 for the first time in 2018, using the modified retrospective adoption method.

The accompanying notes are an integral part of these financial statements.

# Azul S.A.

## Consolidated statements of cash flows Year ended December 31, 2019, 2018 and 2017 (In thousands of Brazilian reais)

	For the year ended December 31,		
	2019	2018 (Restated)	2017 (Restated)
Cash flows from operating activities			
Net income (loss) for the period	(2,403,086)	(635,731)	424,513
Adjustments to reconcile net loss to cash flows provided by (used in) operating activities			
Depreciation, amortization and impairment	3,670,884	1,284,050	1,063,378
Unrealized hedge results	(367,753)	(298,799)	(9,287)
Share-based payment expenses	17,239	17,851	28,141
Exchange (gain) and losses on assets and liabilities denominated in foreign currency	448,901	1,243,882	(37,991)
Interest (income) and expenses on assets and liabilities	1,082,256	866,895	776,470
Related parties	(3,241)	76,949	(73,241)
Deferred income tax and social contribution	(135,407)	171,581	(7,509)
Allowance for doubtful accounts	1,993	5,168	1,586
Provision for inventory	17,791	3,259	(6,218)
Provisions	897,831	70,439	78,469
Loss (profit) on sale of property and equipment and de-recognition of lease contracts	106,914	246,069	(33,168)
Changes in operating assets and liabilities			
Trade and other receivables	(98,803)	(160,427)	(242,739)
Sublease receivables	66,899	4,854	46,859
Inventories	(78,511)	(53,011)	(37,073)
Security deposits and maintenance reserves	(49,431)	(65,030)	(168,940)
Prepaid expenses	(24,483)	(50,475)	(9,979)
Recoverable taxes	(15,718)	(170,950)	(68,403)
Other assets	(103,233)	(210,302)	(101,696)
Derivatives	(2,412)	(373,831)	(157,353)
Accounts payable	87,636	245,785	(95,097)
Accounts payable - Supplier finance	86,949	162,778	-
Salaries, wages and employee benefits	113,563	(2,328)	59,862
Insurance premiums payable	14,939	10,588	147
Taxes payable	(8,417)	12,581	(20,412)
Federal installment payment program	27,326	(8,722)	116,316
Air traffic liability	421,802	322,410	338,074
Provision taxes, civil and labor risks	(93,718)	(62,653)	(81,624)
Other liabilities	(112,578)	(42,680)	52,332
Interest paid	(969,061)	(845,297)	(821,173)
Income tax and social contribution paid	(2,434)	-	-
Net cash provided by operating activities	2,594,637	1,764,903	1,014,244
Cash flows from investing activities			
Short-term investment			
Acquisition of short-term investments	(1,355,455)	(2,843,002)	(3,673,743)
Disposal of short-term investments	1,816,862	3,387,015	3,044,183
Loan granted to third parties	(51,028)	-	-
Disposal of long-term investments	(96,161)	-	1,122
Restricted investments, net	-	5,635	120,925
Proceeds from sale of property and equipment	59,381	363,157	177,316
Acquisition of intangibles	(132,454)	(100,204)	(56,148)
Acquisition of property and equipment	(1,427,965)	(1,086,442)	(695,032)
Net cash used in investing activities	(1,186,820)	(273,841)	(1,081,377)
Cash flows from financing activities			
Debentures			
Proceeds	-	700,000	200,000
Repayment	(64,345)	(168,098)	(1,153,230)
Loans and financing			
Proceeds	592,312	98,940	1,710,650
Repayment	(109,959)	(747,231)	(942,288)
Lease repayment	(1,372,701)	(1,082,239)	(795,010)
Proceeds from sale and leaseback	16,276	11,889	39,461
Issuance of shares due exercise of stock options	37,767	47,634	17,899
Treasury shares	(12,853)	(12,179)	(2,745)
Redemption of preferred shares	-	-	(44,655)
Issued capital, net of issued cost	-	-	1,213,373
Net cash used in by financing activities	(913,503)	(1,151,284)	243,455
Exchange gain (loss) on cash and cash equivalents	(15,570)	67,039	36,833
Net increase (decrease) in cash and cash equivalents	478,744	406,817	213,155
Cash and cash equivalents at the beginning of the period	1,169,136	762,319	549,164
Cash and cash equivalents at the end of the period	1,647,880	1,169,136	762,319

The accompanying notes are an integral part of these financial statements.

# Azul S.A.

Notes to consolidated financial statements

December 31, 2019

(In thousands of Brazilian reais, except when otherwise indicated)

## 1. Operations

Azul S.A. (“Azul”) is a corporation headquartered at Av. Marcos Penteado de Uihôa Rodrigues, 939, in the city of Barueri, in the state of São Paulo, Brazil. Azul was incorporated on January 3, 2008 and is a holding company for providers of airline passenger and cargo services. Azul and its subsidiaries are collectively referred to as the “Company”.

Azul Linhas Aéreas Brasileiras S.A. (“ALAB”), a 100% owned subsidiary incorporated on January 3, 2008, has operated passenger and cargo air transportation in Brazil since beginning operations on December 15, 2008. Canela Investments LLC (“Canela”), a 100% owned special purpose entity, headquartered in the state of Delaware, United States of America, was incorporated on February 28, 2008, to acquire aircraft outside of Brazil and lease them to ALAB.

The Company’s shares are traded on the BM&FBOVESPA and American Depositary Share (“ADS”) on the New York Stock Exchange (“NYSE”).

The consolidated financial statements are comprised of the individual financial statements of the entities as presented below:

Entities	Main activities	Country of incorporation	% equity interest	
			December 31, 2019	December 31, 2018
Azul Linhas Aéreas Brasileiras S.A. (ALAB)	Airline operations	Brazil	100.0%	100.0%
Azul Finance LLC (a)	Aircraft financing	United States	100.0%	100.0%
Azul Finance 2 LLC (a)	Aircraft financing	United States	100.0%	100.0%
Blue Sabiá LLC (a)	Aircraft financing	United States	100.0%	100.0%
ATS Viagens e Turismo Ltda. (a)	Package holidays	Brazil	99.9%	99.9%
Azul SOL LLC (a)	Aircraft financing	United States	100.0%	100.0%
Azul Investment LLP (a)	Group financing	United States	100.0%	100.0%
Fundo Garoupa (b)	Exclusive investment fund	Brazil	100.0%	100.0%
Fundo Safira (a)	Exclusive investment fund	Brazil	100.0%	100.0%
Canela Investments LLC (Canela) (a) (c)	Aircraft financing	United States	100.0%	100.0%
Canela 336 LLC (d) (h)	Aircraft financing	United States	-	100.0%
Canela 407 LLC (d)	Aircraft financing	United States	100.0%	100.0%
Canela 429 LLC (d)	Aircraft financing	United States	100.0%	100.0%
Canela Turbo Three LLC (d)	Aircraft financing	United States	100.0%	100.0%
Daraland S.A. (a)	Holding	Uruguay	100.0%	100.0%
Encenta S.A. (Azul Uruguai) (e)	Airline operations	Uruguay	100.0%	100.0%
TudoAzul S.A.	Loyalty programs	Brazil	100.0%	100.0%
Cruzeiro Participações S.A	Participation in others societies	Brazil	99.9%	99.9%
Global AzulAirProjects, SGPS, S.A. (Global) (g)	Participation in others societies	China	45.45%	-

(a) Azul’s investment is held indirectly through ALAB.

(b) Azul’s investment is held 4% directly and 96% through ALAB.

(c) Transfer of ownership from Azul to ALAB on December 1, 2017.

(d) ALAB’s investments are held indirectly through Canela.

(e) Investments are held indirectly through Daraland.

(f) Subsidiary incorporated on February 6, 2018.

(g) The shares held by HACAIL were transferred to Global on July 1, 2019.

(h) Subsidiary ended August 15, 2019

## **Azul S.A.**

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As of December 31, 2019, the Company had a negative equity position attributed to shareholders of R\$3,519,174 (December 31, 2018 - R\$1,150,038 - restated) and a negative net current position of R\$2,723,289 (December 31, 2018 - R\$1,519,560 - restated). The change in these positions is mainly due to:

- Full retrospective adoption of IFRS 16 - Leases, with an impact of R\$ 4,313,738 on December 31, 2018 in the consolidated accumulated.
- The impairment of 53 Embraer E195 aircraft and associated assets, due to the acceleration of the transformation of the Company's fleet, with a negative impact of R\$2,873,157 in 2019 results.

Management constantly evaluates the profitability of its operations and its financial position, acting in a solid and timely manner to ensure the perpetuity of its operations. With this, it concludes that the Company has conditions for the continuity of its operations and compliance with its obligations, according to their maturities.

Management's assessment considers the Company's business plan that includes future actions planned by Management, as well as other relevant macroeconomic and aviation sector assumptions, such as the estimate of aviation fuel prices and the exchange rate estimate of the US dollar. Among the factors is the plan for the transformation, acceleration and growth of the fleet, with the replacement of older generation aircraft with larger new generation equipment more efficient in terms of fuel consumption. The Company believes that accelerating the transformation of its fleet will generate an incremental operating cash flow between 2020 and 2027, as described in the relevant fact disclosed to the market on January 28, 2020.

According to Management's assessment, the consolidated current assets and the budgetary forecast of cash flows to be generated by the operation will be sufficient to meet the Company's working capital and investment needs in the near future. Based on this assessment, Management concluded that there are no material uncertainties related to the Company's ability to continue operating. Therefore, the financial statements have been prepared based on this premise.

### **Acceleration of fleet transformation**

In 2019, management approved the Embraer E195 phase-out plan, including the sublease of 53 E195 aircraft, following Azul's strategy to accelerate the replacement of its entire domestic fleet of E195 jets with larger, next-generation E2 aircraft that are more fuel-efficient due to new engine technology. This change to the intended use of the aircraft has triggered an impairment review.

A non-financial asset is impaired if its carrying amount exceeds its recoverable amount.

Under IFRS 16, Azul capitalizes the right-of-use of all aircraft previously held under operating leases and depreciates the asset on a straight-line basis over the life of the underlying lease contract or the component useful economic life, whichever is shorter.



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Azul applied the full retrospective transition approach on January 1, 2019, under which the comparative information from prior periods was restated. Upon transition, Azul recognized a right-of-use asset representing its right to use the underlying asset and a corresponding lease liability that were initially measured at the present value of the future lease payments recognized at the historical dollar exchange rate and discount rate. The lease liability is updated at each reporting period to reflect the current exchange rate, whilst the right-of-use carrying value remains at historical rates, in accordance with IAS 21 – The effects of changes in foreign exchange rates.

Recoverable amount is the higher of value in use and fair value less costs of disposal. The value in use of the E195 aircraft and related parts and equipment affected by the acceleration plan was determined using cash flow projections from the phase-out plan approved by senior management covering a seven-year period. The main assumptions used in the analysis included:

- Revenue from sublease contracts
- Delivery and ongoing maintenance costs
- Salvage value for finance lease and owned aircraft at the end of the sublease contracts
- Exchange rate of R\$4.004/US\$1.00
- US Dollar pre-tax discount rate of 10.6%

The fair value less cost to sell of the E195 fleet was determined using third-party valuations and considering specific circumstances of the fleet such as aircraft age, maintenance requirements and condition resulting in a Level 3 classification in the fair value hierarchy.

As a result of the impairment analysis, the Company recorded an impairment of non current assets and right-of-use assets of R\$2,032,207 recognized in “Depreciation, Amortization and Impairment”. In addition in accordance with IAS 36, an impairment charge is not fully allocated if the assets do not have sufficient book value to absorb the charge in its entirety. Consequently, for this portion not absorbed, an additional net cash provision for onerous contract totaling R\$797,591 was recognized in “Other expenses” in the statements of operations, with a corresponding entry to “Provisions” in the balance sheet.

Furthermore, additional assets and liabilities were adjusted to reflect the impact of the accelerated fleet transformation plan including: i) R\$91,826 write-off of prepayments and maintenance reserves not expected to be recoverable; ii) R\$27,999 provision against inventory parts; iii) R\$76,466 reversal of sale and leaseback accrued gains since the carrying value of the aircraft was reduced to its recoverable value.

The total impact of the impairment considering the related provisions and write-offs was R\$54,211 per aircraft.

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## **TwoFlex Acquisition**

On February, 2020 – Azul Linhas Aéreas Brasileiras and Two Taxi Aereo, “TwoFlex”, signed a purchase agreement for Azul to acquire the Brazilian regional carrier TwoFlex for R\$123 million.

TwoFlex offers regular passenger and cargo service to 39 destinations in Brazil, of which only seven regional destinations are currently being served by Azul. The airline also holds 14 daily departure and arrival slots on the auxiliary runway of Congonhas, São Paulo’s downtown airport. Its fleet is composed of 17 owned Cessna Caravan aircraft, and one regional turboprop with a capacity of 9 passengers.

The transaction remains subject to regulatory approvals.

## **2. Basis of preparation of financial statements**

The consolidated financial statements of the Company for the years ended December 31, 2019, 2018 and 2017, were authorized for issuance by the executive board of directors on March 9, 2020.

The consolidated financial statements were prepared in accordance with the International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) and in Brazilian Reais, which is the functional currency of the Company.

The consolidated financial statements provide comparative information in respect of the previous period. In addition, the Company presents an additional statement of financial position at the beginning of the preceding period when there is a retrospective application of an accounting policy, a retrospective restatement, or a reclassification of items in financial statements.

The financial statements were prepared using the historical cost basis, except for certain financial instruments, which are measured at fair value.

The Company has adopted all standards and interpretations issued by the IASB and the IFRS Interpretations Committee that were in effect on December 31, 2019.

## **3. Significant accounting policies**

### **3.1. Basis for consolidation**

The consolidated financial statements comprise the financial statements of Azul and its subsidiaries as of December 31, 2019. Control is achieved when the Company is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Specifically, the Company controls an investee if and only if the Company has:

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- Power over the investee (i.e. existing rights that give it the current ability to direct the relevant activities of the investee)
- Exposure, or rights, to variable returns from its involvement with the investee, and
- The ability to use its power over the investee to affect its returns.

The Company re-assesses whether or not it controls an investee when facts and circumstances indicate that there are changes to one or more of the three elements of control. Consolidation of a subsidiary begins when assets, liabilities, income and expenses of a subsidiary acquired during the year are included in the statement of operations from the date the Company gains control, and ceases on the date the Company loses control of the subsidiary.

When necessary, adjustments are made to the financial statements of subsidiaries to align their accounting policies with those of the Company. All intra-group assets and liabilities, equity, income, expenses and cash flows relating to transactions between members of the Company are eliminated in full on consolidation.

### 3.2. Cash and cash equivalents

Cash and cash equivalents are held in order to meet short-term cash commitments and not for investment or other purposes. The Company considers as cash equivalents deposits or instruments which are readily convertible into a known cash amount and subject to an insignificant risk of change in value. The Company considers as cash equivalents instruments with original maturities of less than three months.

### 3.3 Financial instruments

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

#### 3.3.1. Non-derivative financial assets—initial recognition and subsequent measurement

##### Initial recognition

Non-derivative financial assets, other than trade receivables, are measured at initial recognition at their fair value plus (in the case of a financial asset not at fair value through profit or loss) transaction costs that are directly attributable to the acquisition of the financial asset.

Trade receivables that do not contain a significant financing component are measured at initial recognition at the transaction price.

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### Classification of financial instruments

Under IFRS 9, classification and measurement of financial instruments is based on the business model of the Company to manage financial assets and on the contractual cash flow characteristics of the financial assets.

Financial assets are classified in three categories:

- (i) measured at amortized cost,
- (ii) measured at fair value through other comprehensive income, and
- (iii) measured at fair value through profit or loss

For a financial asset to be classified and measured at amortized cost or at fair value through other comprehensive income, it needs to give rise to cash flows that are "exclusively principal and interest payments" (also referred to as the "SPPI" test) on the principal amount outstanding. This evaluation is performed at instrument level.

The Company's business model for managing financial assets refers to how it manages its financial assets to generate cash flows. The business model determines whether cash flows will result from the collection of contractual cash flows, the sale of financial assets or both.

Purchases or sales of financial assets that require the delivery of assets within a period established by regulation or convention in the market (regular negotiations) are recognized on the trade date, that is, the date on which the Company undertakes to buy or sell the asset.

### Business model assessment

The business model assessment requires classification of the asset in one of the business models defined by IFRS 9. The business models reflect how the Company manages the financial asset in order to generate cash flows on the basis of scenarios that the Company reasonably expects to occur. In order to perform the business model assessment, the Company has grouped financial assets in portfolios of assets that are managed together.

<u>Management Objective</u>	<u>Measurement</u>
Collect contractual payments over the life of the instrument	Amortized cost
Collecting contractual cash flows and selling financial assets	Fair value through other comprehensive income
Held for trading or measured in a fair value basis	Fair value through profit or loss

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### Contractual cash flow characteristics assessment

The contractual cash flow characteristic assessment requires to determine whether the contractual cash flows of the assets consists solely of payment of principal or interest on the principal amount outstanding “SPPI”. When the asset cash flows is SPPI, it will be subsequently measured following the result of the business model assessment. However when the asset cash flows is not SPPI, it will be measured at fair value through profit or loss irrespective of the result of the business model assessment.

### Subsequent measurement of the financial assets of the Company

The criteria for subsequent measurement of the financial assets of the Company is presented below:

- At amortized cost – Financial assets at amortised cost are subsequently measured using the effective interest rate (EIR) method and are subject to impairment. Gains and losses are recognised in profit or loss when the asset is derecognised, modified or impaired.

Financial assets at amortised cost includes: restricted investments, trade and other receivables other than credit card receivables, receivables from related parties, security deposits and maintenance reserves;

- At fair value through other comprehensive income (OCI) – For debt instruments at fair value through OCI, interest income, foreign exchange revaluation and impairment losses or reversals are recognised in the statement of profit or loss and computed in the same manner as for financial assets measured at amortised cost. The remaining fair value changes are recognised in OCI. Upon derecognition, the cumulative fair value change recognised in OCI is recycled to profit or loss.
- At fair value thorough profit of loss – Financial assets at fair value through profit or loss include financial assets held for trading, financial assets designated upon initial recognition at fair value through profit or loss, or financial assets mandatorily required to be measured at fair value. Financial assets are classified as held for trading if they are acquired for the purpose of selling or repurchasing in the near term. Derivatives, including separated embedded derivatives, are also classified as held for trading unless they are designated as effective hedging instruments. Financial assets with cash flows that are not solely payments of principal and interest are classified and measured at fair value through profit or loss, irrespective of the business model. Notwithstanding the criteria for debt instruments to be classified at amortised cost or at fair value through OCI, as described above, debt instruments may be designated at fair value through profit or loss on initial recognition if doing so eliminates, or significantly reduces, an accounting mismatch.

Financial assets at fair value through profit or loss are carried in the statement of financial position at fair value with net changes in fair value recognised in the statement of profit or loss.

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Financial assets at fair value through profit or loss include: Financial instruments, short-term investments and the TAP Convertible Bonds presented under long-term investments

### **3.3.2. Non-derivative financial liabilities—initial recognition and subsequent measurement**

#### Initial recognition

Financial liabilities are initially classified as financial liabilities at fair value through profit or loss, financial liabilities at amortized cost, or as derivatives designated as hedging instruments in an effective hedge, as appropriate.

Non-derivative financial liabilities are measured at initial recognition at its fair value less transaction costs that are directly attributable to the acquisition of the financial asset.

#### Subsequent measurement

The measurement of financial liabilities depends on their classification, as described below:

##### *Financial liabilities at fair value through profit or loss*

Financial liabilities at fair value through profit or loss include financial liabilities held for trading and financial liabilities designated upon initial recognition as at fair value through profit or loss.

Financial liabilities are classified as held for trading if they are incurred for the purpose of repurchasing in the near term. This category also includes derivative financial instruments entered into by the Company that are not designated as hedging instruments in hedge relationships as defined by IFRS 9. Separated embedded derivatives are also classified as held for trading unless they are designated as effective hedging instruments.

Gains or losses on liabilities held for trading are recognised in the statement of profit or loss. Financial liabilities designated upon initial recognition at fair value through profit or loss are designated at the initial date of recognition, and only if the criteria in IFRS 9 are satisfied. The Company has not designated any financial liability as at fair value through profit or loss.

##### *Loans and borrowings*

This is the category most relevant to the Company. After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost using the EIR method. Gains and losses are recognised in profit or loss when the liabilities are derecognised as well as through the EIR amortisation process.

Amortised cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the EIR. The EIR amortisation is included as finance costs in the statement of profit or loss.

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All non-derivative financial liabilities of the Company at the reporting date are measured at amortized cost and consists of loans and financings and accounts payable, except for those designated as hedge item in a fair value hedge (Note 24).

### **3.3.3. Financial instruments and hedge accounting – Initial recognition and subsequent measurement**

#### Initial recognition and subsequent measurement

The Company uses financial instruments, such as currency forward contracts options and NDF to hedge itself against the currency risk, heating oil swaps to hedge the fuel price risk and interest rate swaps to hedge against the interest risk. Financial instruments not designated as hedge instruments are recognized initially at fair value on the date when the derivative contract is entered into and are subsequently remeasured at fair value. The accounting for subsequent changes in fair value to derivatives that are hedge instruments in a hedge accounting depends of the nature of the item being hedged and the type of hedge relationship designated. Derivatives are presented as financial assets when the instrument's fair value is positive and as financial liabilities when fair value is negative. Any gains or losses from changes in the fair value of derivatives not designated to hedge accounting during the year are recorded directly in profit or loss. The accounting treatments for derivatives designated as hedge instruments are presented in the next topic.

#### Hedge accounting

The following classifications are used for hedge accounting purposes:

- Fair value hedge when hedging against exposure to changes in fair value of recognized assets or liabilities, or an unrecognized firm commitment.
- Cash flow hedge when providing protection against changes in cash flows that is attributable to a particular risk associated with a recognized asset or liability or a highly probable forecast transaction which may affect the income or foreign currency risk in an unrecognized firm commitment.

On inception of a hedge relationship, the Company formally designates and documents the hedge relationship to which the Company wishes to apply hedge accounting, as well as the Company's objective and risk management strategy for undertaking the hedge. The documentation includes identification of the hedge instrument and item or transaction being hedged, the nature of the risk being hedged and risks excluded, and effectiveness assessment approach using prospect basis proving the existence of economic relationship between the hedged item and hedge instrument, that credit risk does not dominate the value changes that results from that economic relationship and how the hedge ratio is determined, including possible sources of ineffectiveness by performing a qualitative (when the critical terms of hedged item and hedge instrument match or are closely aligned – as nominal amount, maturity and underlying) or quantitative.

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Hedges that meet the criteria for hedge accounting are accounted for as follows:

### Fair value hedge

The gain or loss resulting from changes in fair value of a hedge instrument (for derivative hedge instrument) or the foreign exchange component of its carrying amount is recognized in profit or loss or other comprehensive income, if the hedging instruments hedges an equity instrument for which the Company has elected to present changes in fair value in other comprehensive income. The gain or loss on the hedged item shall adjust the carrying amount of the hedged item (for on-balance item) and be recognized in profit or loss.

If the hedged item is derecognized, the unamortized fair value is recognized immediately in profit or loss.

When an unrecognized firm sales commitment is designated as a hedged item in a hedge relationship, the change in fair value of the firm sales commitment attributable to the hedge risk is recognized as a financial asset or as a financial liability, with the recognition of a corresponding gain or loss in the statements of operations. The accumulated balance in the statement of financial position resulting from successive changes in fair value of the firm sales commitment attributable to the hedged risk will be transferred to the balance of the hedged item upon its recognition (recognition of balance is either of accounts payable or accounts receivable).

The Company holds interest rate swaps to hedge against its exposure to changes in fair value of some of its aircraft financing (Note 24).

### Cash flow hedge

The effective portion of a gain or loss from the hedge instrument is recognized directly in other comprehensive income. When the hedge ratio is not aligned, giving rise to ineffectiveness, but the risk management strategy is the same, the Company shall rebalance the hedge ratio in order to meet the hedge effectiveness requirements.

Any gain or loss remaining from the hedge instrument (as result of the rebalancing) is deemed an ineffectiveness and shall be recorded in profit or loss.

The amounts recorded in other comprehensive loss are transferred to the statement of net income (loss) in tandem with the hedged transaction impact on profit or loss. For example, when a forecasted sale occurs or when the income or expense being hedged is recognized. When the hedged item is the cost of a non-financial asset or non-financial liability, the amounts recorded as other comprehensive loss are transferred to initial carrying amount of the non-financial assets or liability.

The Company shall discontinue hedge accounting prospectively only when the hedging relationship ceases to meet the qualifying criteria (after taking into account any rebalancing of the hedging relationship).



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If the occurrence of the forecast transaction or firm commitment is no longer likely, the amounts previously recognized in other comprehensive loss are transferred to the statement of net income (loss). If the hedge instrument expires or is sold, terminated, exercised without replacement or rollover, or if its designation as a hedge is revoked, any cumulative gain or loss previously recognized in comprehensive loss remains deferred in other comprehensive loss until the forecast transaction or firm commitment affects profit or loss.

The Company uses swap contracts to hedge against its exposure to the risk of changes in floating rates related to its finance lease transactions and currency option to hedge the notional amount of debt denominated in foreign currency.

#### Current and non-current classification

Derivative instruments that are not classified as effective hedge instruments are classified as current, non-current or segregated into current or non-current portions based on the underlying contractual cash flows.

- When the Company expects to maintain a derivative as an economic hedge (and to not apply hedge accounting) for a period exceeding 12 months after the statement of financial position date, the derivative is classified as non-current (or segregated into current and non-current portions), consistent with the classification of the underlying item.
- Embedded derivatives that are not closely related to the host contract are classified in a manner consistent with the cash flows of the host contract.
- Derivative instruments that are designated as and are effective hedge instruments are classified consistently with the classification of the underlying hedged item. The derivative instrument is segregated into current and non-current portion only if a reliable allocation can be made.

### **3.3.4. Derecognition of financial assets and financial liabilities**

#### Financial assets

Financial assets, or where appropriate, part of a financial asset or part of a group of similar financial assets, are derecognized when:

- The rights to receive cash flows from the assets have expired; or
- The Company has transferred their rights to receive cash flows of the assets and (a) the Company has substantially transferred all the risks and benefits of the assets, or (b) the Company has not transferred or retained substantially all the risks and benefits related to the assets, but has transferred control of the assets.

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When the Company has transferred their rights to receive cash flows from assets and has not transferred all the risks and rewards relating to an asset, that asset is recognized to the extent of the continuing involvement of the Company. In this situation, the Company also recognizes an associated liability.

The transferred assets and associated liabilities are measured based on the rights and obligations that the Company has retained.

Continuing involvement that takes the form of a guarantee on the assets transferred is measured by the original book value of the assets or the maximum payment that may be required from the Company, whichever is lower.

### Financial liabilities

A financial liability is derecognized when the obligation under the liability is discharged, cancelled or expires.

When an existing financial liability is replaced by another from the same lender with substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as the derecognition of the original liability and the recognition of a new liability, with the difference in the corresponding book values recognized in the statements of operations.

### **3.3.5. Offsetting of financial instruments**

Financial assets and financial liabilities are offset and the net amount reported in the consolidated statement of financial position if there is a currently enforceable legal right to offset the recognized amounts and there is an intention to settle on a net basis, to realize the assets and settle the liability simultaneously.

### **3.3.6. Impairment of financial assets**

The Company recognizes an allowance for losses on financial assets for expected credit losses in line of IFRS 9 requirements.

### Trade receivables and contract assets

The Company uses the simplified approach allowed by IFRS 9 to estimate the allowance for losses on trade receivables.

Under the simplified approach, the Company estimates expected credit losses over the life of the receivables at the reporting date (which in all cases have a contractual life shorter than 12 months) since they result from transactions with customers and do not have a significant financing component.

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In estimating expected credit losses the Company considers credit card receivables as receivables with a low risk of default. Considering that it has a relevant history of no credit risk losses on such receivables and that it does not expect losses during the lifetime of those receivables no allowance has been recognized for those assets.

In order to estimate expected credit losses for other trade receivables and contract assets, the Company aggregates such assets in portfolios of receivables which share credit risk characteristics. The Company currently uses portfolios to estimate credit losses. For each portfolio, the Company measures the historic rate of losses (net of recoveries) on defaulted receivables over a relevant historic period considering that, generally, a receivable has defaulted when it is more than 90 days overdue. Such historical default rate for the portfolio is subsequently adjusted to incorporate an estimate of the impact of future economic conditions on past historic rates.

The estimate of the impact of future economic conditions is based on the observed correlation of defaults with macroeconomic indicators. The Company periodically reviews the historic period over which defaults are measured and, the relevant macroeconomic indicator to use and how the correlate with the experience of defaults.

### Other financial assets

For other financial assets, the Company assesses individually for each counterparty whether there has been a significant increase in the credit risk of the asset since initial recognition or not. Such determination is based on information already available to the Company. If and when credit risk ratings of the counterparty are publicly available, such information is also taken into consideration.

For financial assets with no significant increase in credit risk, an estimate is made of expected credit losses that result from default events on a financial instrument that are possible within the 12 months after the reporting date. For those assets with a significant increase in credit risk, the estimate is made of losses that result from default events that are possible over the lifetime of the asset.

An allowance for loss is recognized when the Company estimates that the risk of credit losses during the period exists. In measuring the allowance, the Company considers at least three scenarios (standard, optimistic and pessimistic) and for each an estimate of cash inflows (including cash inflows from collateral) is made. The resulting estimated cash flows for each scenario is discounted to present value to the reporting date and are probability-weighted based on a judgmental determination of the probability of each scenario.

### **3.3.7. Fair value of financial instruments**

The fair value of financial instruments actively traded in organized financial markets is determined based on prices quoted in the market at close of business at the statement of financial position date, not including the deduction of transaction costs.

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The fair value of financial instruments for which there is no active market is determined using valuation techniques. These techniques can include use of recent market transactions, references to the current fair value of other similar instruments, analysis of discounted cash flows, or other valuation models.

An analysis of the fair value of derivative financial instruments and more details about how they are calculated is described in Note 24.

### **3.4. Inventories**

Inventories consist of aircraft maintenance parts, snack supplies and uniforms. Inventories are valued at cost or net realizable value, whichever is lower, net of any provision for inventory.

### **3.5. Taxes**

Income tax expense, deferred tax assets and liabilities reflect management's best assessment of estimated current and future taxes to be paid. Significant management judgment is required to determine the amount of deferred tax assets that can be recognized and the tax rates used, based upon the likely timing and the level of future taxable profits together with future tax planning strategies. In Brazil, income tax is determined on each legal entity, that is, not on a consolidated basis.

Provisions for income tax and social contribution are based on the taxable income of the year considering the offset of tax loss carryforwards, up to the limit of 30% of annual taxable income. Tax rates and tax laws used to calculate the amounts are those in force at the statement of financial position dates. The income from foreign subsidiaries is subject to taxation pursuant to local tax rates and legislation. In Brazil, these incomes are taxed according to Law 12.973/14.

Deferred income taxes and social contribution arise from temporary differences between the tax basis of assets and liabilities and their reported amounts in the financial statements, which will result in taxable or deductible amounts in the future.

Deferred income tax assets and liabilities are measured at tax rates that are expected to be applicable in the year that the assets will be realized or the liability settled, based on tax rates (and tax law) enacted or substantially enacted on each statement of financial position date.

The book value of the deferred tax assets is presented net if there is a legal or contractual right to offset tax assets against tax liabilities and deferred taxes are related to the same taxable entity and is reviewed on each statement of financial position date and written off to the extent that it is no longer probable that taxable profits will be available to allow that all or part of the deferred taxes assets will be used.

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Unrecognized deferred tax assets are reassessed on each statement of financial position date and are recognized to the extent that it becomes probable that future taxable profit will allow that the deferred tax assets be recovered.

Deferred income tax and social contribution relating to equity items are recognized directly in equity. The Company assesses on a regular basis the tax status of situations in which tax law requires interpretation and records provisions if appropriate.

### 3.6. Foreign currency transactions

The consolidated financial statements are presented in Brazilian reais (R\$), which is the Company's functional currency.

Transactions in foreign currencies are initially translated into Brazilian reais using the exchange rates prevailing at the date of the transaction.

Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency using the exchange rates prevailing at the statement of financial position date.

Non-monetary items denominated in foreign currency at historical cost basis are translated into the functional currency using the exchange rates on the dates of original transactions. Non-monetary items denominated in foreign currency measured at fair value are translated using the exchange rates prevailing on the date of determination of fair value.

Differences arising on settlement or transaction of monetary items are recognized in the statement of net income (loss). Changes in fair value of the hedging instruments are recorded using the accounting treatment described in note 3.3.3 "Financial instruments".

### 3.7. Property and equipment

Assets included in property and equipment are stated at acquisition or construction cost including interest and other financial charges.

Depreciation is calculated using the straight-line method over the estimated useful lives of the assets as follows:

	Estimated useful lives
Aircraft	12 years
Furniture and fixtures	5 years
Aircraft equipment	12 years
Computer equipment and peripherals	5 years
Tools	5 years
Heavy maintenance – engines	3 to 8 years
Heavy maintenance – structural checks	2 to 10 years
Engines	12 years
Leasehold improvements	10 years
Simulators	20 years
Vehicles	5 years

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The net book value and useful life of assets and the depreciation methods are reviewed at the end of each year and adjusted prospectively, if necessary.

The book value of property and equipment is tested for impairment when there is an indicator that the carrying value may be greater than the estimated recoverable amount.

An item of property, plant and equipment and any significant part initially recognized is derecognized upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is recognized in "Other operating expenses, net".

### 3.7.1. Lease

The Company assesses at contract inception whether a contract is, or contains, a lease. That is, if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

The Company applies a single recognition and measurement approach for all leases, except for short-term leases and leases of low-value assets. The Company recognizes lease liabilities to make lease payments and right-of-use assets representing the right to use the underlying assets.

#### *Right-of-use assets*

The Company recognizes right-of-use assets at the commencement date of the lease (i.e., the date the underlying asset is available for use). Right-of-use assets are measured at cost, less any accumulated depreciation and impairment losses, and adjusted for any remeasurement of lease liabilities (except for the impact of changes in foreign exchange rates). The cost of right-of-use assets includes the amount of lease liabilities recognized at the discount rate and foreign exchange rate at commencement date, initial direct costs incurred, and lease payments made at or before the commencement date, plus the initial estimate of restoration costs expected to be incurred at the end of the contract, less any lease incentives received. Right-of-use assets are depreciated on a straight-line basis over the shorter of the lease term and the estimated useful lives of the assets. If ownership of the leased asset transfers to the Company at the end of the lease term or the cost reflects the exercise of a purchase option, depreciation is calculated using the estimated useful life of the asset.

The right-of-use assets are also subject to impairment.

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### *Lease liabilities*

At the commencement date of the lease, the Company recognizes lease liabilities measured at the present value of lease payments to be made over the lease term. The lease payments include fixed payments (including insubstance fixed payments) less any lease incentives receivable, variable lease payments that depend on an index or a rate, and amounts expected to be paid under residual value guarantees. The lease payments also include the exercise price of a purchase option reasonably certain to be exercised by the Company and payments of penalties for terminating the lease, if the lease term reflects the Company exercising the option to terminate.

Variable lease payments that do not depend on an index or a rate are recognized as expenses (unless they are incurred to produce inventories) in the period in which the event or condition that triggers the payment occurs. In 2018 and 2019, the total expenses related to the variable lease payments were immaterial.

In calculating the present value of lease payments, the Company uses the interest rate implicit in the lease and, when it is not readily available, the incremental borrowing nominal rate at the lease commencement date.

In determining the discount rate, the Company used, in each of the years in which assets were incorporated into the balance sheet, the cost of raising debt in the American and Brazilian markets. For operations in the Brazilian market, the Company converted the cost to the equivalent of a dollar transaction, adjusting for the country risk and interest rate differential between Brazil and United States. Thus, we understand that the inflationary effects are irrelevant, especially considering that 99.4% of the Company's leases are determined in US dollars.

After the commencement date, the amount of lease liabilities is increased to reflect the accretion of interest and reduced for the lease payments made. In addition, the carrying amount of lease liabilities is remeasured if there is a modification, a change in the lease term, a change in the lease payments (e.g., changes to future payments resulting from a change in an index or rate used to determine such lease payments) or a change in the assessment of an option to purchase the underlying asset.

### *Short-term leases and leases of low-value assets*

The Company applies the short-term lease recognition exemption to its short-term leases of machinery and equipment (i.e., those leases that have a lease term of 12 months or less from the commencement date and do not contain a purchase option). It also applies the lease of low-value assets recognition exemption to leases of office equipment that are considered to be low value. Lease payments on short-term leases and leases of low value assets are recognized as expense on a straight-line basis over the lease term. In 2018 and 2019, the total expenses related to the leases of low value assets were immaterial.

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### **3.7.2. Sale and leaseback transaction**

If the Company transfers the asset to another entity and leases it back from the buyer, the Company applies the requirements under IFRS 15 to determine if the transaction qualifies as a sale for which revenue is recognized, or whether the transaction is a collateralized borrowing.

If the transfer of the asset qualifies as a sale under IFRS 15, the Company measures a right-of-use asset arising from the leaseback as the proportion of the carrying amount of the asset that relates to the right-of-use retained. The gain (or loss) that the Company recognizes is limited to the proportion of the total gain (or loss) that relates to the rights transferred to the buyer-lessor.

If the transfer of the asset does not meet the requirements of IFRS 15 to be accounted for as a sale of the asset, the Company continues to recognize the transferred asset and recognizes a financial liability equivalent to the cash received from the transfer in accordance with the requirements of IFRS 9.

### **3.7.3. Sublease transaction**

When the underlying asset is leased again by the Company to a third party, and the original lease remains in effect, the Company assesses whether it is a finance or operating sublease by analyzing the extent to which the lease transfers the risks and benefits inherent in the right of use.

Regardless of the sublease classification, the accounting for the lease liability of the original lease remains unchanged.

- Finance sublease: the Company de-recognizes the right of use asset and recognizes a sublease receivable. The difference between the net book value of depreciation of the right of use and the present value of the sublease receivable is recognized immediately in the income statement under the heading "Other operating expenses, net".
- Operating sublease: the Company continues to recognize the right of use, which in turn continues to depreciate in accordance with the Company's policy. Sublease revenue is recognized throughout the sublease contract under the heading "Cargo and other revenues".



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### **3.7.4. Aircraft and right-of-use decomponentization and capitalization of heavy maintenance events and structural checks**

At the initial recognition of aircraft or right-of-use assets, the Company allocates the total cost of the aircraft between four major components; airframe, engines, heavy maintenance and structural checks. The useful economic life is the period extending up to the next heavy maintenance or structural check or the remaining useful life of the aircraft/engines or lease contract, whichever is shorter.

The Company has maintenance contracts for its engines that cover all significant maintenance events. The Company has "power-by-the-hour" type contracts, which estipulate a rate for maintenance per hour flown, which are paid in accordance with the total hours flown when maintenance occurs.

Subsequent heavy maintenance events and structural checks, which increase the useful lives of the assets, are capitalized and recognized as property and equipment or in addition to the right-of-use assets, according to the underlying asset. Subsequently they are depreciated during the respective period of use or until the end of the lease. Repairs and other routine maintenance are recognized in the maintenance expenses during the period in which they are incurred.

### **3.7.5. Capitalization of contractual obligations with aircraft return conditions**

The costs resulting from the maintenance events that will be carried out immediately before the return of the aircraft to the lessors (defined as restoration events under IFRS 16) are recognized as provisions from the beginning of the contract, as long as they can be reasonably estimated. In addition, a right-of-use asset is recognized and depreciated on a straight-line basis over the lease term.

### **3.7.6. Advance payments for acquisition of aircraft**

Advance payments for acquisition of aircraft are recorded in property and equipment, including interest and financial charges incurred during the aircraft manufacturing phase and improvements to third-party assets.

The Company receives credits from manufacturers when purchasing certain aircraft and engines, which can be used to pay for maintenance services. These credits are recorded as a reduction in the acquisition cost of related aircraft and engines, against a charge to other accounts receivable and then recorded as an expense or asset, when the credits are used for the additional acquisition of goods or services.

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### **3.8. Business Combinations**

The Company accounts for business combinations using the acquisition method. The cost of an acquisition is measured as the sum of the consideration transferred, based on its fair value on the acquisition date. Costs directly attributable to the acquisition are expensed as incurred. The assets acquired and liabilities assumed are measured at fair value, classified and allocated according to the contractual terms, economic circumstances and relevant conditions on the acquisition date. Goodwill is measured as the excess of the consideration transferred over the fair value of net assets acquired. If the consideration transferred is smaller than the fair value of net assets acquired, the difference is recognized as a gain on bargain purchase in the statement of net income (loss). After initial recognition, goodwill is measured at cost less any accumulated impairment losses. For the years ended December 31, 2019 and 2018, the Company has not completed any business combination transaction.

For combinations between entities under common control, the Company accounts under the Predecessor Accounting Method. Assets and liabilities of the acquired entity are stated at predecessor carrying values. These intra-group transactions have no impact in the consolidated financial statements.

### **3.9. Intangible assets**

Separately acquired intangible assets are measured at cost on initial recognition. After initial recognition, intangible assets are stated at cost, less any accumulated amortization and accumulated impairment losses. Internally generated goodwill are not capitalized.

The useful life of intangible assets is assessed as definite or indefinite.

Intangible assets with definite useful lives are amortized over their estimated useful lives and tested for impairment, whenever there is an indication of any loss in the economic value of the assets. The period and method of amortization for intangible assets with definite lives are reviewed at least at the end of each fiscal year or when there are indicators of impairment. Changes in estimated useful lives or expected consumption of future economic benefits embodied in the assets are considered to modify the amortization period or method, as appropriate, and treated as changes in accounting estimates. The amortization of intangible assets with definite lives is recognized in the statements of operations in the expense category consistent with the use of intangible assets (Note 15).

Intangible assets with indefinite useful lives are not amortized, but are tested for impairment at each year-end or whenever there is an indicator that their carrying amount cannot be recovered. The assessment is reviewed annually to determine whether the indefinite useful life continues to be supportable. If not, the change in useful life from the indefinite to definite is made on a prospective basis.

Gains and losses resulting from the disposal of intangible assets are measured as the difference between the net disposal proceeds and the book value of assets, and are recognized in the statements of operations.

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In connection with the acquisition of TudoAzul (former TRIP), the Company identified airport operating licenses as having indefinite useful lives. The fair value of Pampulha, Santos Dumont and Fernando de Noronha airports operating licenses were recognized at fair value at the acquisition date. Fair value of operating licenses was based on estimated discounted future cash flows. Operating licenses are considered to have indefinite useful lives due to several factors, including requirements for necessary permits to operate within Brazil and limited landing rights availability in Brazil's most important airports regarding traffic volume.

### 3.10. Impairment of non-financial assets

The Company performs an annual review for impairment indicators in order to assess events or changes in economic, technological, or operating conditions which may indicate that an asset is not recoverable.

If any, those indicators are identified when performing the annual impairment testing and the Company estimates the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash generating unit's (CGU) fair value less cost to sell or its value in use. When the carrying amount of intangibles exceed its recoverable amount, an impairment charge is recorded and the asset is written down to its recoverable amount.

The reversal of an impairment loss should be recognized if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment test was carried out. The amount of any reversal that can be recognized is restricted to increasing the relevant asset's carrying value to the carrying value that would have been recognized if the original impairment had not occurred.

The Company operates as a single CGU.

In estimating the value in use of assets, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects the weighted average cost of capital for the industry in which the cash-generating unit operates. The fair value less cost to sell is determined, whenever possible, based on a firm sales agreement carried out on an arm's length basis between known and interested parties, adjusted for expenses attributable to asset sales, or when there is no firm sale commitment, based on the market price of an active market or most recent transaction price of similar assets.

The following assets have specific characteristics for impairment testing:

#### Goodwill

Goodwill is tested for impairment annually or when circumstances indicate that the carrying value may not be recoverable.

Impairment is determined for goodwill by assessing the recoverable amount of the single CGU taking the Company as a whole.

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When the recoverable amount of the CGU is less than its carrying amount, an impairment loss is recognized. Impairment losses relating to goodwill cannot be reversed in future periods.

### Intangible assets

Intangible assets with indefinite useful lives are tested for impairment annually at the CGU level, and when circumstances indicate that the carrying value may be impaired.

## **3.11. Security deposits and maintenance reserves**

### a) Security deposits

Security deposits are guarantee deposits held as collateral related to aircraft lease contracts paid to lessors at the inception of the lease agreement that will be refunded to the Company when the aircraft is returned to the lessor at the end of the lease agreement. Security deposits are denominated in U.S. Dollars and do not bear interest.

### b) Maintenance reserves

Certain master lease agreements provide that we pay maintenance reserves to aircraft lessors to be held as collateral in advance of the performance of major maintenance activities. Maintenance reserve deposits are reimbursable to us upon completion of the maintenance event in an amount equal to the lesser of (1) the amount of the maintenance reserve held by the lessor associated with the specific maintenance event or (2) the costs related to the specific maintenance event. Substantially all of these maintenance reserve payments are calculated based on a utilization measure, such as flight hours or cycles, and are used solely to collateralize the lessor for maintenance.

At the lease inception and at each statement of financial position date, we assess whether the maintenance reserve payments required by the master lease agreements are expected to be recovered through the performance of qualifying maintenance on the leased assets. Maintenance deposits expected to be recovered from lessors are reflected in security deposits and maintenance reserves in the accompanying statements of financial position. We assess recoverability of amounts currently on deposit with a lessor by comparing them to the amounts that are expected to be reimbursed at the time of the next maintenance event, and amounts not recoverable are considered maintenance costs. Aircraft maintenance reserves are classified as current or non-current depending on the dates when the related maintenance is expected to be performed (comparative figures, previously presented as non-current on its entirety, have been reclassified to improve comparability between periods presented).

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### 3.12. Provisions

Provisions are recognized when the Company has a present legal or constructive obligation, and as a result of past events, it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate of the amount can be made.

When the Company expects that the value of a provision will be reimbursed, in whole or in part, as for example under an insurance contract, the reimbursement is recognized as a separate asset but only when reimbursement is virtually certain. The expense relating to any provision is presented in the statements of operations, net of any reimbursement.

The Company is party in other judicial and administrative proceedings. Provisions are set up for all legal claims related to lawsuits for which it is probable that an outflow of funds will be required to settle the legal claims obligation and a reasonable estimate can be made. The assessment of probability of loss includes assessing the available evidence, the hierarchy of laws, the most recent court decision and their relevance in the legal system, as well as the assessment of legal counsel.

If the Company identifies an onerous contract, a contract in which the unavoidable costs of meeting the obligations of the contract exceed the economic benefits expected to be received over the same contract, the present obligation under the contract is recognized and measured as a provision. However, before a separate provision for an onerous contract is established, the Company assesses and recognizes any impairment losses that have occurred on the assets related to that contract in accordance with IAS 36 – Impairment.

### 3.13. Treasury shares

Own equity instruments that are reacquired (treasury shares) are recognized at cost and deducted from equity. No gain or loss is recognized in profit or loss on the purchase, sale, issue or cancellation of the Company own equity instruments. Any difference between the carrying amount and the consideration, if reissued, is recognized in the share premium.

### 3.14. Employee benefits

#### i) Executive bonus

The Company records a provision for executive bonus, which payment is contingent to meeting predefined goals and it is recorded under Salaries, wages and benefits.

#### ii) Share-based payment

The Company offered its executives share-based payments to be settled with Company shares, where the Company receives services provided by these professionals in consideration for share options and restricted stock units.

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The cost of equity settled awards with employees is measured based on the fair value as of the grant date. In order to determine the fair value of share options, the Company uses the Black-Scholes option pricing model (Note 28).

The cost of equity-settled awards is recognized together with a corresponding increase in equity over the period in which performance and/or service conditions are fulfilled, ending on the date the employee acquires the full right to the award (vesting date). The cumulative expense for equity settled transactions at each reporting date until the vesting date reflects the extent to which the vesting period has expired and management's best estimate of the number of equity instruments that will be vested.

The expense or credit in the statement of the operations for the period is recorded in "Salaries, wages and benefits" and represents the change in the accumulated expense recognized in the period.

No expense is recognized for awards that do not vest, except for awards in which vesting is subject to a market or non-vesting condition. These are treated as vested, regardless of whether the market conditions are met or not, provided that all the other exercise conditions are met.

When the terms of an equity-settled award are modified, the minimum expense is that which would have been recognized had the terms not been modified. An additional expense is recognized for any modification that increases the total fair value of the share-based payment transaction or otherwise benefits the employee, as measured at the date of modification.

When an equity-settled award is cancelled, it is treated as having vested on the cancellation date and any expense not recognized for the award is immediately recognized. This includes any award in which the non-vesting conditions within the control of the Company or the counterparty are not met. However, if a new plan replaces the plan canceled and designated as a replacement award on the date of grant, the canceled plan and the new plan are treated as if they were a modification to the original plan, as described in the previous paragraph.

The cost of cash-settled transactions is measured initially at fair value at the grant date. This fair value is expensed over the service period with the recognition of a corresponding liability. The liability is remeasured to fair value at each reporting date up to, and including the settlement date, with changes in fair value recognized in the statement of the operations for the period in 'Salaries, wages and benefits'.

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### **3.15. Accounts payable – Supplier finance**

The Company negotiated with suppliers to extend payment terms. As a result, the Company signed an agreement with financial institutions to allow the anticipation of trade receivables from its suppliers. Taking into account that the early receipt with financial institutions is an option for suppliers, this does not generate financial expenses for the Company, it does not require the mandatory participation of suppliers, and the Company is neither refunded and/nor benefited with discounts from the financial institution due to prepayment before the maturity date agreed upon with the supplier. There is no change in the bill subordination level in the event of judicial execution.

### **3.16. Revenue**

Passenger tickets revenue is recognized upon effective rendering of the transportation service. Travel-related services revenue is recognized when the related transportation service is provided being classified as passenger revenue. Travel-related services include baggage fees, administrative charges, upgrades and other travel related charges.

The Company recognizes revenue for tickets and travel-related services sold upon the departure of the related scheduled flight and for tickets and travel-related services sold that are expected to expire unused (breakage). The Company estimates the value of future refunds and exchanges, net of forfeitures for all unused tickets, once the flight date has already passed. These estimates are based on historical data and experience from past events.

IFRS 15 requires disclosure of quantitative and qualitative information about transaction price allocation to unsatisfied or partially satisfied performance obligations. The Company decided to apply the practical expedient to not disclose such information as the performance obligations are part of contracts with expected duration of one year or less.

### **3.17. “TudoAzul” Program**

Under the “TudoAzul” program, customers accrue points based on the amount spent on tickets flown. The amount of points earned depends on TudoAzul membership status, market, flight, day of week, advance purchase, booking class and other factors, including promotional campaigns. The Company recognizes revenue on points that are estimated to expire unused. Points in general expire two years after the date earned regardless of activity in the account.

Upon the sale of a ticket, the Company recognizes a portion of the ticket sales as revenue when the transportation service occurs and defers a portion corresponding to the points earned under the TudoAzul Program, in accordance with IFRS 15, Customer Loyalty Programs in the account “Air Traffic Liabilities”.

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The Company determines the estimated selling price of the air transportation and points as if each element had been sold on a separate basis and was therefore based on the stand alone selling price.

The Company sells points to customers and also to business partners, including co-branded credit cards, financial institutions and other businesses. The related revenue is deferred and recognized as passenger revenue when points are redeemed and the related transportation service occurs, based on the weighted average price of the points sold.

Sales of points are comprised of two components, transportation and marketing. Accordingly, we recognize the marketing component in “other revenue” based on contractual terms.

Points awarded or sold and not used are recorded in “Air traffic liability”. The Company recognizes revenue for points sold and awarded that will never be redeemed by program members. The Company estimates such amounts annually based upon the latest available information regarding redemption and expiration patterns.

### 3.18. Segment information

IFRS 8 requires that operations are identified by segment based on internal reports that are regularly reviewed by the Company’s chief operating decision maker to allocate funds to segments and assess their performance.

The operations of the Company consist of air transportation services in Brazil. The Company’s management allocates funds based on the consolidated results. The main revenue-generating assets of the Company are its aircraft, from which revenue is generated in Brazil. Other revenues are basically derived from cargo operations and all items are directly attributed to air transport services that are recognized in income for the year when the services are rendered.

Based on how the Company manages its business and the way in which fund allocation decisions are taken, the Company has only one operating segment for financial reporting purposes.

### 3.19. New and amended standards and interpretations

#### **IFRS 16**

IFRS 16 was issued in January 2016 and replaces IAS 17, *Leases*, IFRIC 4, *Determining whether an Agreement Contains a Lease*, SIC-15, *Operating leases-Incentives* and SIC-27 – *Evaluating the Substance of Transactions in the Legal Form of a Lease*.

IFRS 16 is effective for annual periods beginning on or after January 1, 2019.



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### **Transition to IFRS 16**

A lessee can apply IFRS 16 either by a full retrospective approach or a modified retrospective approach. Azul applied the full retrospective transition approach on January 1, 2019 to each prior reporting period presented. Under the full retrospective method the comparative information was restated.

Azul elected to use the exemptions proposed by the standard on lease contracts for which the lease terms ends within 12 months as of the date of initial application, and lease contracts for which the underlying asset is of low value. Azul has leases of certain equipment (i.e., personal computers, printing and photocopying machines as well as communicating equipment) that are considered of low value.

The impact of IFRS 16 adoption is presented as follows:

	December 31, 2018			December 31, 2017			January 01, 2017		
	As reported	IFRS 16 Impact	As adjusted	As reported	IFRS 16 Impact	As adjusted	As reported	IFRS 16 Impact	As adjusted
<b>Consolidated Balance Sheets</b>									
<b><u>Asset</u></b>									
<b><u>Current assets</u></b>									
Sublease receivable (e)	-	73,671	73,671	-	57,768	57,768	-	52,278	52,278
Prepaid expenses (g)	163,829	(48,376)	115,453	109,784	(27,128)	82,656	97,501	(23,997)	73,504
Other-current assets (h)	111,714	(1,091)	110,623	199,225	(418)	198,807	-	-	-
<b><u>Non-current assets</u></b>									
Sublease receivable (e)	-	288,067	288,067	-	308,824	308,824	-	361,173	361,173
Other non-current assets (g), (h)	520,723	(123,325)	397,398	215,707	(45,891)	169,816	-	4,063,048	4,063,048
ROU - leased aircraft and other assets (a), (b), (g), (j)	-	4,926,326	4,926,326	-	4,377,725	4,377,725	-	115,259	115,259
ROU - maintenance of leased aircraft (d), (g)	-	632,900	632,900	-	374,384	374,384	-	-	-
Property, plant and equipment (b)	3,289,219	(1,446,980)	1,842,239	3,325,535	(1,444,764)	1,880,771	3,439,980	(1,318,328)	2,121,652
<b><u>Liabilities and equity</u></b>									
<b><u>Current liabilities</u></b>									
Loans and financing (c)	335,051	(176,238)	158,813	568,234	(149,036)	419,198	985,238	(151,825)	833,413
Lease liabilities (a), (c)	-	1,237,909	1,237,909	-	914,600	914,600	-	790,819	790,819
Accounts payable (e)	1,166,291	121,370	1,287,661	953,534	18,216	971,750	1,034,317	19,789	1,054,106
Provisions (j)	-	36,083	36,083	-	-	-	-	-	-
<b><u>Non-current liabilities</u></b>									
Loans and financing (c)	3,370,971	(773,658)	2,597,313	2,921,653	(762,412)	2,159,241	3,049,257	(850,129)	2,199,128
Lease liabilities (a), (c)	-	7,681,837	7,681,837	-	6,428,893	6,428,893	-	6,242,168	6,242,168
Deferred income taxes (i)	443,894	(150,683)	293,211	326,911	(184,809)	142,102	181,462	(96,904)	84,558
Provisions (j), (e)	80,984	632,957	713,941	73,198	479,957	553,155	76,353	402,644	478,997
Other non-current liabilities (e), (h)	321,139	5,353	326,492	343,041	79,672	422,713	377,924	21,642	399,566
<b><u>Equity</u></b>									
Other comprehensive income (i)	(117,324)	(36,645)	(153,969)	(11,192)	(3,496)	(14,688)	(33,785)	(12,212)	(45,997)
Accumulated losses	(836,214)	(4,277,093)	(5,113,307)	(1,214,756)	(3,221,085)	(4,435,841)	(1,743,795)	(3,116,559)	(4,860,354)

(\*) ROU - Right-of-use assets

# Azul S.A.

## Notes to consolidated financial statements

Years ended December 31, 2019, 2018 and 2017

(In thousands of Brazilian reais, except when otherwise indicated)

Consolidated statement of net income (loss)	For the year ended December 31, 2018			For the year ended December 31, 2017		
	As reported	IFRS 16 Impact	As adjusted	As reported	IFRS 16 Impact	As adjusted
<b>Operating revenue</b>						
Cargo and other revenue (f)	483,225	(96,293)	386,932	1,094,157	(84,666)	1,009,491
<b>Operating expense</b>						
Maintenance materials and repairs (d)	(504,477)	254,372	(250,105)	(568,144)	83,988	(484,156)
Depreciation and amortization (a), (j)	(324,902)	(959,148)	(1,284,050)	(299,793)	(763,585)	(1,063,378)
Other operating expenses, net (h)	(875,148)	(6,268)	(881,416)	(572,497)	(4,078)	(576,575)
Other operating expenses, net - aircraft and other rent (a)	(1,509,947)	1,475,513	(34,434)	(1,181,731)	1,146,112	(35,619)
<b>Financial result</b>						
Financial income (e)	41,393	33,129	74,522	94,805	33,467	128,272
Financial expense (a), (j)	(410,207)	(684,621)	(1,094,828)	(524,033)	(554,565)	(1,078,598)
Foreign currency exchange, net (a), (e), (j)	(194,706)	(1,111,357)	(1,306,063)	57,871	(23,012)	34,859
Result from related parties transactions, net (e)	342,083	39,642	381,725	194,351	(17,376)	176,975
<b>Income tax</b>						
Income tax expense	(170,604)	(977)	(171,581)	(71,680)	79,189	7,509
<b>Net income (loss)</b>	420,277	(1,056,008)	(635,731)	529,039	(104,526)	424,513
Basic net income per common share - R\$	0.02	(0.05)	(0.03)	0.02	(0.00)	0.02
Diluted net income per common share - R\$	0.02	(0.05)	(0.03)	0.02	(0.00)	0.02
Basic net income per preferred share - R\$	1.24	(3.13)	(1.88)	1.68	(0.33)	1.35
Diluted net income per preferred share - R\$	1.23	(3.13)	(1.88)	1.64	(0.33)	1.32
<b>Cash Flows</b>	<b>As reported</b>	<b>IFRS 16 Impact</b>	<b>As adjusted</b>	<b>As reported</b>	<b>IFRS 16 Impact</b>	<b>As adjusted</b>
<b>Cash flows from operating activities</b>						
Net income (loss) for the period	420,277	(1,056,008)	(635,731)	529,039	(104,526)	424,513
Adjustments to reconcile net loss to cash flows provided by (used in) operating activities						
Depreciation and amortization	324,902	959,148	1,284,050	299,793	763,585	1,063,378
Exchange (gain) and losses on assets and liabilities denominated in foreign currency	90,141	1,153,741	1,243,882	(62,236)	24,245	(37,991)
Interest (income) and expenses on assets and liabilities	182,274	684,621	866,895	222,127	554,343	776,470
Deferred income tax and social contribution	170,604	977	171,581	71,680	(79,189)	(7,509)
<b>Changes in operating assets and liabilities</b>						
Sublease receivables	-	4,854	4,854	-	46,859	46,859
Prepaid expenses	(71,723)	21,248	(50,475)	(20,017)	10,038	(9,979)
Other assets	(288,409)	78,107	(210,302)	(141,108)	39,412	(101,696)
Accounts payable	142,631	103,154	245,785	(93,524)	(1,573)	(95,097)
Other liabilities	31,639	(74,319)	(42,680)	(5,689)	58,021	52,332
Interest paid	(214,671)	(630,626)	(845,297)	(301,943)	(519,230)	(821,173)
<b>Cash flows from investing activities</b>						
Acquisition of property and equipment	(754,637)	(331,805)	(1,086,442)	(589,497)	(105,535)	(695,032)
<b>Cash flows from financing activities</b>						
Loan proceeds	-	-	-	1,750,111	(39,461)	1,710,650
Loan payment	(530,472)	(216,759)	(747,231)	(889,066)	(53,222)	(942,288)
Lease payment	(385,906)	(696,333)	(1,082,239)	(201,246)	(593,764)	(795,010)

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### Notes to consolidated financial statements

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- a) The application of IFRS 16 to leases previously classified as operating leases under IAS 17, resulted in the recognition of right-of-use assets and lease liabilities. As a result, aircraft and other rent expenses have decreased, offset by an increase in depreciation and amortization expense, finance expense and foreign currency exchange expense.
- b) Finance lease aircraft, previously recognized in property, plant and equipment, and are now presented as a right-of-use asset.
- c) Finance lease liabilities, previously recognized as loans and financing, are now presented as lease liabilities.
- d) Heavy maintenance and structural checks expenses related to aircraft under operating lease were previously recorded under Maintenance materials and repairs expenses. Under IFRS 16, these expenses are capitalized and depreciated.
- e) The Company, as a lessor, has classified its sublease agreements as finance leases and operating leases, depending on the extent to which the lease transfers the risks and benefits inherent to the asset or right-of-use. For subleases classified as finance subleases, the leased assets have been de-recognized and a sublease receivables recorded. The provision for onerous contract of the 7 aircraft subleased to TAP, previously required under IAS 17 (Note 9), and was adjusted to reflect only the non avoidable costs non lease related. The revenue recorded for finance leases consists only of financial income and the sublease receivable balance is adjusted each accounting period for change to foreign exchange rates.
- f) For subleases classified as operating subleases, the Company continues to recognize the right-of-use asset, which continues to depreciate in accordance with the Company's policy. Sublease revenue is recognized through the sublease under the heading "Cargo and other revenues".
- g) The Company had prepaid rent and maintenance expenses which have been incorporated in the right-of-use asset balances.
- h) The Company had deferred sale and leaseback losses which, upon transition, were recognized as a loss at the time of the transaction and corresponding amortization expenses previously recognized under IAS 17 were reversed.
- i) Deferred tax assets are recognized only to the extent that recovery is probable.
- j) Costs resulting from maintenance events that will be carried out immediately before the aircraft is returned to lessors (defined as restoration events under IFRS 16), are recognized as provisions from the beginning of the contract, provided that they can be estimated reasonably, against the recognition of a right-of-use asset, which is depreciated on a straight-line basis over the lease.

The Company's aircraft lease rental payments are predominantly denominated in USD. While the Company's foreign currency cash flow risk for lease rental payments are unchanged, the adoption of IFRS 16 will result in foreign currency denominated lease liabilities recognized on the balance sheet revaluing in response to exchange rate fluctuations in the USD/BRL exchange rate.

### **Amendments to IFRS 9: *Prepayment Features with Negative Compensation***

Under IFRS 9, a debt instrument can be measured at amortized cost or at fair value through other comprehensive income, provided that the contractual cash flows are solely payments of principal and interest on the principal amount outstanding (the SPPI criterion) and the instrument is held within the appropriate business model for that classification. The amendments to IFRS 9 clarify that a financial asset passes the SPPI criterion regardless of an event or circumstance that causes the early termination of the contract and irrespective of which party pays or receives reasonable compensation for the early termination of the contract. These amendments had no impact on the consolidated financial statements of the Company.

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### **Amendments to IAS 19: *Plan Amendment, Curtailment or Settlement***

The amendments to IAS 19 address the accounting when a plan amendment, curtailment or settlement occurs during a reporting period. The amendments specify that when a plan amendment, curtailment or settlement occurs during the annual reporting period, an Company is required to determine the current service cost for the remainder of the period after the plan amendment, curtailment or settlement, using the actuarial assumptions used to remeasure the net defined benefit liability (asset) reflecting the benefits offered under the plan and the plan assets after that event. A Company is also required to determine the net interest for the remainder of the period after the plan amendment, curtailment or settlement using the net defined benefit liability (asset) reflecting the benefits offered under the plan and the plan assets after that event, and the discount rate used to remeasure that net defined benefit liability (asset).

The amendments had no impact on the consolidated financial statements of the Company as it did not have any plan amendments, curtailments, or settlements during the period.

### **Amendments to IAS 28: *Long-term interests in associates and joint ventures***

The amendments clarify that a Company applies IFRS 9 to long-term interests in an associate or joint venture to which the equity method is not applied but that, in substance, form part of the net investment in the associate or joint venture (long-term interests). This clarification is relevant because it implies that the expected credit loss model in IFRS 9 applies to such long-term interests.

The amendments also clarified that, in applying IFRS 9, a Company does not take account of any losses of the associate or joint venture, or any impairment losses on the net investment, recognized as adjustments to the net investment in the associate or joint venture that arise from applying IAS 28 *Investments in Associates and Joint Ventures*.

These amendments had no impact on the consolidated financial statements as the Company does not have longterm interests in its associate and joint venture.

### **IFRIC Interpretation 23 *Uncertainty over Income Tax Treatment***

The Interpretation addresses the accounting for income taxes when tax treatments involve uncertainty that affects the application of IAS 12 *Income Taxes*. It does not apply to taxes or levies outside the scope of IAS 12, nor does it specifically include requirements relating to interest and penalties associated with uncertain tax treatments. The Interpretation specifically addresses the following:

- Whether a Company considers uncertain tax treatments separately
- The assumptions a Company makes about the examination of tax treatments by taxation authorities
- How a Company determines taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates

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- How a Company considers changes in facts and circumstances

The Company determines whether to consider each uncertain tax treatment separately or together with one or more other uncertain tax treatments and uses the approach that better predicts the resolution of the uncertainty.

The Company applies significant judgement in identifying uncertainties over income tax treatments. Since the Company operates in a complex multinational environment, it assessed whether the Interpretation had an impact on its consolidated financial statements.

Upon adoption of the Interpretation, the Company considered whether it has any uncertain tax positions, particularly those relating to transfer pricing. The Company's and the subsidiaries' tax filings in different jurisdictions include deductions related to transfer pricing and the taxation authorities may challenge those tax treatments. The Company determined, based on its tax compliance and transfer pricing study that it is probable that its tax treatments (including those for the subsidiaries) will be accepted by the taxation authorities.

The Interpretation did not have an impact on the consolidated financial statements of the Company.

### **Annual Improvements 2015-2017 Cycle**

#### **IFRS 3 Business Combinations**

The amendments clarify that, when a Company obtains control of a business that is a joint operation, it applies the requirements for a business combination achieved in stages, including remeasuring previously held interests in the assets and liabilities of the joint operation at fair value. In doing so, the acquirer remeasures its entire previously held interest in the joint operation.

A Company applies those amendments to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2019, with early application permitted.

These amendments had no impact on the consolidated financial statements of the Company as there is no transaction where joint control is obtained.

#### **IFRS 11 Joint Arrangements**

A Company that participates in, but does not have joint control of, a joint operation might obtain joint control of the joint operation in which the activity of the joint operation constitutes a business as defined in IFRS 3. The amendments clarify that the previously held interests in that joint operation are not remeasured.

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A Company applies those amendments to transactions in which it obtains joint control on or after the beginning of the first annual reporting period beginning on or after January 1, 2019, with early application permitted.

These amendments had no impact on the consolidated financial statements of the Company as there is no transaction where a joint control is obtained.

### **IAS 12 Income Taxes**

The amendments clarify that the income tax consequences of dividends are linked more directly to past transactions or events that generated distributable profits than to distributions to owners. Therefore, a Company recognizes the income tax consequences of dividends in profit or loss, other comprehensive income or equity according to where it originally recognized those past transactions or events.

Company applies the amendments for annual reporting periods beginning on or after January 1, 2019, with early application permitted. When the Company first applies those amendments, it applies them to the income tax consequences of dividends recognized on or after the beginning of the earliest comparative period.

Since the Company's current practice is in line with these amendments, they had no impact on the consolidated financial statements of the Company.

### **IAS 23 Borrowing Costs**

The amendments clarify that a Company treats as part of general borrowings any borrowing originally made to develop a qualifying asset when substantially all of the activities necessary to prepare that asset for its intended use or sale are complete.

The Company applies the amendments to borrowing costs incurred on or after the beginning of the annual reporting period in which the Company first applies those amendments. Company applies those amendments for annual reporting periods beginning on or after January 1, 2019, with early application permitted.

Since the Company's current practice is in line with these amendments, they had no impact on the consolidated financial statements of the Company.

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### 3.20. Standards issued but not yet effective

#### **Amendments to IFRS 3: *Definition of a Business***

In October 2018, the IASB issued amendments to the definition of a business in IFRS 3 *Business Combinations* to help entities determine whether an acquired set of activities and assets is a business or not. They clarify the minimum requirements for a business, remove the assessment of whether market participants are capable of replacing any missing elements, add guidance to help entities assess whether an acquired process is substantive, narrow the definitions of a business and of outputs, and introduce an optional fair value concentration test. New illustrative examples were provided along with the amendments.

Since the amendments apply prospectively to transactions or other events that occur on or after the date of first application, the Group will not be affected by these amendments on the date of transition.

#### **Amendments to IAS 1 and IAS 8: *Definition of Material***

In October 2018, the IASB issued amendments to IAS 1 *Presentation of Financial Statements* and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to align the definition of 'material' across the standards and to clarify certain aspects of the definition. The new definition states that, Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.

The amendments to the definition of material is not expected to have a significant impact on the Company consolidated financial statements.

#### **Amendments to IFRS 9 – Financial Instruments, IAS 39 – Financial Instruments: Recognition and Measurement and IFRS 7 – Financial Instruments: Disclosures**

Due to the changes in the interest rates used as market references – IBOR (Interbank Offered Rate), that will be terminated in future periods, there may be uncertainties in the evaluation of hedge accounting structures. Regulatory changes aim at minimizing possible impacts in these structures in the current scenario of prereplacement of rates. These changes are effective for the years beginning January 1, 2020. No significant impacts have been identified on the Consolidated Financial Statements of Company.

#### **IFRS 17 *Insurance Contracts***

In May 2017, the IASB issued IFRS 17 *Insurance Contracts* (IFRS 17), a comprehensive new accounting standard for insurance contracts covering recognition and measurement, presentation and disclosure.

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IFRS 17 is effective for reporting periods beginning on or after January 1, 2021, with comparative figures required. This standard is not applicable to the Company.

### 4. Significant accounting judgments, assumptions and estimates

The preparation of consolidated financial statements of the Company requires management to make judgments and estimates and adopt assumptions that affect the reported amounts of revenue, expenses, assets, liabilities and disclosures of contingent liabilities at the date of the financial statements. Uncertainty relating to these assumptions and estimates could lead to amounts that require a significant adjustment to the book value of assets or liabilities affected in future periods.

In the process of applying the Company's accounting policies, management has made the following judgments, estimates and assumptions which have the most significant effect on the amounts recognized in the consolidated financial statements:

#### Estimates and assumptions

The main assumptions concerning the future and other key sources of estimation uncertainty at the reporting date, involving a significant risk of causing a material adjustment of the book value of assets and liabilities within the next financial year, are discussed below:

#### *Breakage*

The Company recognizes revenue from tickets sold that are expected to expire unused based on historical data and experience. Estimating expected breakage requires management to make judgments, among other things, on the extent to which historical experience is an indication of customer behavior. Annually, or more frequently as the experience data suggests, management reassesses the historical data and makes required improvements.

#### *Impairment of non-financial assets*

An impairment loss exists when the book value of assets or cash-generating unit exceeds its recoverable amount, which is the higher of fair value less sales costs and value in use. The calculation of fair value less sales cost is based on information available of transaction of similar assets or market price less additional costs for disposing of assets.

The calculation of value in use is based on the discounted cash flow model. Cash flows are derived from the budget for the next five or seven years and do not include reorganization activities to which the Company have not yet committed or significant future investments that will improve the basis of assets of the cash-generating unit subject to the test.

The recoverable amount is affected by the discount rate used in the method of discounted cash flow and expected future cash receipts and growth rate used for extrapolation.



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### *Transactions with share-based payments*

The Company measures the cost of transactions settled with its own shares with employees based on the fair value of such shares at the grant date or at each reporting date, as applicable. The Company must estimate at each reporting date the quantity of awards expected to be vested considering performance and non-market vesting conditions. Estimating the fair value of share-based payments requires determining the most appropriate assessment model for the grant of shares, which depends on the terms and conditions of the grant. This also requires determining the inputs used in the valuation models, including the option's expected life, volatility, dividend income, and related assumptions. The assumptions and models used to estimate the fair value of share-based payments are disclosed in Note 28.

### *Provisions for tax, civil and labor risks*

The Company recognizes provisions for civil and labor suits. The assessment of probability of loss includes assessing the available evidence and jurisprudence, the hierarchy of laws and most recent court decisions, and their relevance in the legal system, or the assessment of independent counsel. Provisions are reviewed and adjusted to take into account changes in circumstances such as the applicable limitation period, findings of tax inspections and additional exposures identified based on new issues or decisions of courts (Note 21).

### *Fair value of financial instruments*

When the fair value of assets and liabilities presented in the statement of financial position cannot be obtained in an active market, it is determined using valuation techniques including the discounted cash flow model. The data for these methods is based on those prevailing in the market when possible. However, when it is not feasible, a certain level of judgment is required to establish fair value. Judgment includes considerations on the data used, for example, liquidity risk, credit risk and volatility. Changes in assumptions about these factors could affect the fair value of the financial instruments.

### *“TudoAzul” Program - Loyalty Plan*

As described in Note 3.17, the Company accounts for “TudoAzul” loyalty program using the deferred revenue method. Under the deferred revenue method, the Company accounts for awarded points as a separately identifiable component of the sales transactions in which they are granted and recognizes based on the relative individual selling price. Deferred revenue, other than breakage on points, remains recognized until customers redeem their points, or when the points expire.

### *Provision for return of aircraft and engines*

For aircraft under operating leases, the Company is contractually required to return the equipment at a predefined level of operational capability.

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The aircraft return cost provision is estimated based on expenditures incurred in aircraft reconfiguration (interior and exterior), licensing and technical certification, painting etc., according to return terms.

The engine's return cost provision is estimated based on evaluation and minimum contractual conditions of the equipment that should be returned to the lessor, considering not only the historical costs incurred, but also the equipment conditions at the time of evaluation.

### *Determination of useful life and significant components of property and equipment and right-of-use*

The Company believes that important aircraft parts need to be separated, including engines, their respective scheduled heavy maintenance and structural checks. These parts are depreciated in accordance with the useful lives defined in the fleet renovation plan and the maintenance schedule.

### *Discount rate used for the initial lease calculation*

When calculating the present value of lease payments, the Company uses the interest rate implicit in the lease and, when this cannot be readily determined, the Company's incremental borrowing rate at the lease commencement date is used.

The incremental borrowing rate is calculated based on the risk-free interest rate for a similar term and a similar economic environment to the lease, as of the lease commencement date, adjusted for the risk spread of the Company and the collateral specific to the lease.

## **5. Financial risk management objectives and policies**

The main financial liabilities of the Company, other than derivatives, are loans, debentures, lease payables and accounts payable. The main purpose of these financial liabilities is to finance operations as well as finance the acquisition of aircraft. The Company has trade accounts receivable and other accounts receivable that result directly from its operations. The Company also has investments available for trading and contracts for derivative transactions such as currency forwards, options and swaps in order to reduce the exposure to foreign exchange fluctuations.

The Company's senior management supervises the management of market, credit and liquidity risks.

All activities with derivatives for risk management purposes are carried out by experts with the appropriate skillset and experience and under senior management supervision. It is the Company's policy not to enter into derivatives transactions for speculative purposes.

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#### a) Market risk

Market risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk consists of three types of risk: interest rate risk, currency risk and other price risk, such as equity price risk and commodity risk. Financial instruments exposed to market risk include loans payable, deposits, financial instruments measured at fair value through profit or loss and financial instruments.

On July 24, 2019, the Company entered in a structured derivative transaction to hedge US\$28 million related to the release of a new financing tranche from Opic. The contracted structure was a full swap of principal and interest of all transaction flows at a rate of R\$3.7731 and also includes sale of currency options at R\$4.7500 for interest and principal. This operation was designated as economic hedge.

The table below shows the effects of our hedges designated as hedge accounting of our debt:

	December 31, 2019		
	Book value	Fair Value – hedge instrument	Consolidated post hedge strategy
<b>Denominated in foreign currency - US\$</b>			
Aircraft and engine acquisition	896,232	(10,971)	885,261
Working capital	1,727,882	(303,507)	1,424,375
<b>Denominated in local currency - R\$</b>			
Aircraft and engine acquisition (FINAME)	164,280	(3,309)	160,971
Working capital	37,355	-	37,355
Finance lease			
Total in R\$	2,825,749	(317,787)	2,507,962

The table below shows the indebtedness related to working capital denominated in foreign currency, designated as hedge accounting, considering the effects of the derivative instruments (exchanging the exposure for local currency) contracted by the Company:

Risk	Type of hedge	Hedged Item	Nominal amount	Hedge Instrument	Nominal amount	December 31, 2019		
						Carrying amount hedge item	Fair Value – hedge instrument	Debt Considering Hedge
1) Senior Notes Azul LLP								
Foreign exchange risk	Cash Flow Hedge	Principal US\$ on Senior Notes Azul LLP	US\$ 400 million	Currency Options - Floor 3,2865 Cap 4,7500	US\$ 400 million	1,605,914	(282,760)	1,323,154
2) Proceeds in foreign currency								
Interest rate swap and foreign exchange risk	Fair value hedge	Principal & Interest on 4.131 Transaction	US\$30 million	IRS - Interest Rate Swap (receives US Libor3M + spread & pays 108% CDI)	98,940	121,968	(20,747)	101,221
Total						1,727,882	(303,507)	1,424,375

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The table below shows the indebtedness related to aircraft acquisition denominated in foreign currency, designated as hedge accounting, considering the effects of the derivative instruments (exchanging the exposure for local currency) contracted by the Company:

Risk	Type of hedge	Hedged Item	Nominal amount	Hedge Instrument	Nominal amount	December 31, 2019		
						Carrying amount - hedge item	Fair Value – hedge instrument	Debt Considering Hedge
Aircraft acquisition								
Interest rate swap and foreign exchange risk	Cash Flow Hedge	Principal US\$ on OPIC	US\$79 million	Currency Options - Floor 3,8070 Cap 4,7500	US\$79 million	594,586	(10,971)	583,615
Interest rate swap and foreign exchange risk	Fair value hedge	Principal & Interest	R\$76,200	IRS - Interest Rate Swap (fixed 6% to 58% and 61% of CDI)	R\$76,200	44,249	(3,309)	40,940
						638,835	(14,280)	624,555

### a.1) Interest rate risk

Interest rate risk is the risk that the fair value of future results of a financial instrument fluctuates due to changes in market interest rates. The exposure of the Company to the risk of changes in market interest rates refers primarily to long-term obligations subject to variable interest rates.

The Company manages interest rate risk by monitoring the future projections of interest rates on its loans, financing and debentures as well as on its operating leases. To mitigate this risk, the Company has used derivative instruments aimed at minimizing any negative impact of variations in interest rates.

#### Sensitivity to interest rates

The table below shows the sensitivity to possible changes in interest rates, keeping all other variables constant in the Company's income before taxes that are impacted by loans payable subject to variable interest rates. For the sensitivity analysis, the Company utilized the following assumptions:

- LIBOR based debt: weighted average interest rate of 5.34% p.a.
- CDI based debt: weighted average interest rate of 4.74% p.a.

We estimated the impact on profit and loss and equity for the year ended December 31, 2019 resulting from variation of 25% and 50% on the weighted average rates, as shown below:

	25%	-25%	50%	-50%
Interest expense	29,430	(29,430)	58,860	(58,860)

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#### a.2) Currency risk

Currency risk is the risk that the fair value of future dollar denominated commitments vary according to the fluctuation of the foreign exchange rate. The exposure of the Company to changes in exchange rates relates primarily to the U.S dollar denominated loans, financing and leases, net of investments in the U.S. dollar, and also to revenues and operating expenses originated in U.S. dollar.

The Company is also exposed to changes in the exchange rate of the Euro through its investment in the TAP Convertible Bonds (Note 24).

The Company manages its currency risk by using financial instruments seeking to hedge up to twelve months of its projected non-operational activities.

The Company continuously monitors the net exposure in foreign currency and, when deemed appropriate, enters into arrangements to hedge the projected non-operating cash flow for up to 12 months to minimize its exposure. Additionally, the Company may enter into longer than 12 months derivative financial instruments to protect itself against currency and/or interest rate risks related to "Loans and financing".

The Company's nominal foreign exchange exposure is shown below:

	Exposure to U.S. dollar		Exposure to Euro	
	December 31,		December 31,	
	2019	2018	2019	2018
	(Restated)			
<b>Assets</b>				
Cash and cash equivalents and short-term				
Investments	289,297	356,174	-	-
Security deposits and maintenance reserves	1,613,221	1,513,963	-	-
Sublease receivables	279,504	361,738	-	-
Long-term investments	160,871	-	1,236,828	1,287,781
Financial instruments	121,968	116,564	-	-
Other assets	244,355	122,456	-	-
<b>Total assets</b>	<b>2,709,216</b>	<b>2,470,895</b>	<b>1,236,828</b>	<b>1,287,781</b>
<b>Liabilities</b>				
Accounts payable	(424,411)	(455,777)	-	-
Loans and financing (*)	(2,624,114)	(1,756,989)	-	-
Lease liabilities	(12,034,392)	(8,948,314)	-	-
Other liabilities	(688,134)	(44,925)	-	-
<b>Total liabilities</b>	<b>(15,771,051)</b>	<b>(11,206,005)</b>	<b>-</b>	<b>-</b>
<b>Derivatives (NDF) – notional</b>	<b>2,940,333</b>	<b>2,186,356</b>	<b>-</b>	<b>-</b>
<b>Net exposure</b>	<b>(10,121,502)</b>	<b>(6,548,754)</b>	<b>1,236,828</b>	<b>1,287,781</b>

(\*) As of December 31, 2019, US dollar denominated working capital loans totaling R\$2,158,933 were swapped to Brazilian Reais, yielding a non-realized gain of R\$314,500 and resulting in a net US dollar exposure on Loans and Financing of R\$465,181.

## Azul S.A.

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### Sensitivity to exchange rates

At December 31, 2019, the Company used the closing exchange rate of R\$4.0307/US\$1.00 and R\$4.5305/EUR1.00. We present below a sensitivity analysis considering a variation of 25% and 50% over the existing rates:

Exposure in US\$	25%	-25%	50%	-50%
	R\$5.0384/US\$	R\$3.0230/US\$	R\$6.0461/US\$	R\$2.0154/US\$
Effect on exchange rate variation	(2,530,398)	2,530,398	(5,060,797)	5,060,797

Exposure in EUR	25%	-25%	50%	-50%
	R\$5.6631/EUR	R\$3.3979/EUR	R\$6.7958/EUR	R\$2.2653/EUR
Effect on exchange rate variation	309,207	(309,207)	618,414	(618,414)

### a.3) *Risks related to variations in prices of aircraft fuel*

The volatility of prices of aircraft fuel is one of the most significant financial risks for airlines. The company's fuel price risk management aims to balance the airline exposure to its market peers, so that the airline is neither overly affected by a sudden increase in prices nor is unable to benefit from a substantial fall in fuel prices.

The Company manages the risk related to fuel price volatility either through forward-looking fixed-price contracts directly with a supplier, or derivative contracts negotiated with banks. The Company may use derivative contracts for oil or its sub-products.

### Fuel price sensitivity

The table below sets out the sensitivity of the Company's fuel hedges to substantial changes in the oil markets, maintaining all other variables constant.

The analysis considers a change in oil prices, in Reais, relative to the market average for the current period and forecast the impact on the Company's financial instruments, stemming from a variation of 25% and 50% in the oil prices, using the closing exchange rate of R\$4.0307/US\$1.00 as follows:

Change in Oil prices in Reais	25%	-25%	50%	-50%
Impact on fuel hedges	379,673	(261,317)	700,031	(582,002)

### a.4) *Risk related to changes in the fair value of TAP Convertible Bonds and investments in Global AzulAirProjects*

TAP Convertible Bonds contain a conversion option into shares of TAP. In addition *Global AzulAirProjects* retains 35.6% economic rights in Atlantic Gateway, which in turn retains 6.1% post-dilution economic interest in TAP. Therefore, the Company is exposed to changes in the fair value of TAP.

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The acquisition of the TAP Convertible Bonds and the participation in Global AzulAirProjects is part of the commercial strategy of the Company of creating synergies between the Company and TAP by having the option to become a direct shareholder of TAP in case the stock price of TAP increases and it is economically advantageous to convert the debt into TAP shares.

### b) Credit risk

Credit risk is inherent in operating and financial activities of the Company, mainly represented under the headings of trade receivables, cash and cash equivalents, including bank deposits.

The credit risk of "trade receivables" is comprised of amounts payable by major credit card companies, and also trade receivables from travel agencies, and sales payable in installments. The Company usually assesses the corresponding risks of financial instruments and diversifies the exposure.

Financial instruments are held with counterparties that are rated at least "A" in the assessment made by S&P, Moody's and Fitch, or, mostly, are held in futures and commodities stock exchange, which substantially mitigates the credit risk.

TAP Convertible Bonds are secured by liens over certain intangible assets.

Additionally, the Company, under the non-binding agreement to acquire selected assets of Oceanair Linhas Aéreas SA ("Avianca Brasil"), granted loans in the aggregate and non-adjusted total amount of R\$52 million to Avianca Brasil, which have contractual guarantees of surety and chattel mortgage of equipment. Such loans are recorded under "Other assets" and must be paid with priority under the law and the judicial recovery plan of Avianca Brasil.

During the second quarter of 2019, there was an auction for the sale of isolated production units, pursuant to Avianca's judicial recovery plan, whose proceeds would primarily serve to repay the loans. To date, the judicial sale of isolated production units has not been completed, including in view of the decision of the National Civil Aviation Agency (ANAC) to redistribute slots. The Company continues to monitor the evolution of the judicial recovery process of Avianca Brasil and its developments in order to verify the recoverability of the loans by this means, as well as adopting all applicable enforceable measures to collect the debtor and guarantors amounts.

### c) Liquidity risk

Liquidity risk takes on two distinct forms: market and cash flow liquidity risk. The first is related to current market prices and varies in accordance with the type of asset and the markets where they are traded. Cash flow liquidity risk, however, is related to difficulties in meeting the contracted operating obligations at the agreed dates.

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As a way of managing the liquidity risk, the Company invests its funds in liquid assets (government bonds, CDBs, and investment funds with daily liquidity), and the cash management policy establishes that the Company's and its subsidiaries' weighted average debt maturity should be higher than the weighted average maturity of the investment portfolio.

The schedule of financial liabilities held by the Company is as follows:

December 31, 2019	Immediate	Until 6 months	7 to 12 months	1 to 5 years	More than 5 years	Total
Loans and financing	42,619	162,269	276,339	3,003,090	33,839	3,518,156
Lease liabilities	271,524	598,472	715,237	8,081,759	2,439,629	12,106,621
Accounts payable	975,465	277,388	123,997	-	-	1,376,850
Accounts payable – Supplier finance	249,727	-	-	-	-	249,727
Liabilities from derivative transaction	2,135	46,987	32,074	228,994	-	310,190
	1,541,470	1,085,116	1,147,647	11,313,843	2,473,468	17,561,544

### Capital management

The Company's assets may be financed through equity or third-party financing. If the Company opts for equity capital it may use funds from contributions by shareholders or through selling its equity instruments.

The use of third-party financing is an option to be considered mainly when the Company believes that the cost would be less than the return generated by an acquired asset. It is important to ensure that the Company maintains an optimized capital structure, provides financial solidity while providing for the viability of its business plan. As a capital-intensive industry with considerable investments in assets with a high aggregated value, it is natural for companies in the aviation sector to report a relatively high degree of leverage.

The Company manages capital through leverage ratios, which is defined by the Company as net debt divided by the sum of net debt and total equity. Management seeks to maintain this ratio at levels equal to or lower than industry levels. Management includes in the net debt the lease liabilities, the loans and financing (including debentures) less cash and cash equivalents, restricted cash, short and long-term investments, sublease receivables, deposits and current and non-current restricted investments.

The Company's capital structure is comprised of its net indebtedness defined as total loans and financing (including debentures) and operating leases net of cash and cash equivalents, restricted cash and others financial instruments. Capital is defined as equity and net indebtedness.

Under IFRS 16, at the commencement date of the lease, the Company recognizes lease liabilities measured at the present value of lease payments to be made over the lease term. During the fourth quarter 2019, the Company took delivery of thirteen aircraft under operating leases, increasing the 'Lease liabilities' by R\$2,124,722. Although the liability is recognized in the balance sheet from delivery date, these aircraft generated nearly no Operating income (loss) during the quarter, as aircraft are required to go through certification and tests before joining the operating fleet of the Company.



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The Company is not subject to any externally imposed capital requirements. The total capital as total net equity and net debt as detailed below:

	December 31,	
	2019	2018 (Restated)
Equity	<b>(3,519,174)</b>	(1,150,038)
Cash and cash equivalents (Note 6)	<b>(1,647,880)</b>	(1,169,136)
Short-term investments (Note 7)	<b>(62,009)</b>	(517,423)
Long-term investments (Note 24)	<b>(1,397,699)</b>	(1,287,781)
Sublease receivable (Nota 9)	<b>(279,504)</b>	(361,738)
Security deposits and maintenance reserves (Note 13)	<b>(1,651,533)</b>	(1,546,720)
Loans and financing (Note 17)	<b>3,518,156</b>	2,756,126
Lease liabilities (Note 18)	<b>12,106,621</b>	8,919,746
Net debt	<b>10,586,152</b>	6,793,074
Total capital	<b>7,066,978</b>	5,643,036

## 6. Cash and cash equivalents

Cash and cash equivalents are comprised of the following:

	December 31,	
	2019	2018
Cash and bank deposits	<b>308,958</b>	370,262
Cash equivalents		
Bank Deposit Certificate – CDB	<b>1,317,388</b>	480,052
Investments funds	<b>21,534</b>	318,822
	<b>1,647,880</b>	1,169,136

The balances of cash and bank deposits represent amounts deposited in checking accounts with Brazilian and offshore banks.

The CDB investments are indexed to the Brazilian Interbank Deposit Certificate (“CDI”) and are repayable on demand.

Investment funds are comprised of CDBs and repurchase agreements, denominated in Reais, with financial institutions (deposit certificates).

Cash equivalents investments are classified as financial assets at fair value through profit or loss.

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### 7. Short term investments

Investments are comprised of:

	December 31,	
	2019	2018
Other short-term investments	21,243	16,039
Investment funds	40,766	501,384
	<b>62,009</b>	<b>517,423</b>

Investment funds are comprised of Brazilian government bonds and bank notes, denominated in Reais, with financial institutions (deposit certificates) and debentures issued by B and BB+ risk rated companies bearing an accumulated average interest rate of 100% of CDI – Interbank Deposit Certificate rate. Brazilian government bonds are comprised of National Treasury Bills (“LTN”), National Financial Bills (“LFT”) and National Treasury Notes (“NTN”).

Short-term investments are classified as financial assets at fair value through profit or loss.

### 8. Trade and other receivables

	December 31,	
	2019	2018
Trade and other receivables with customers	1,142,704	1,039,373
Trade and other receivables with others	37,878	42,406
	<b>1,180,582</b>	<b>1,081,779</b>
Allowance for doubtful accounts	(14,716)	(12,723)
	<b>1,165,866</b>	<b>1,069,056</b>

The changes in the allowance for doubtful accounts are as follows:

	December 31,	
	2019	2018
Balance at the beginning of the year	12,723	6,925
Increases	5,532	7,505
Reversals	(3,539)	(1,707)
Balance at the end of the year	<b>14,716</b>	<b>12,723</b>

The schedule of accounts receivables are as follows:

	December 31,	
	2019	2018
Not yet due	1,151,963	1,025,211
Up to 90 days	13,903	43,845
Over 91 days	14,716	12,723
	<b>1,180,582</b>	<b>1,081,779</b>

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Accounts receivable from credit card companies are received in installments of up to twelve months. Installment receivables which are due more than 60 days amounted to R\$495,707 at December 31, 2019 (December 31, 2018 – R\$691,839). Average days-sales-outstanding was 31 days for the year ended December 31, 2019 (December 31, 2018 - 37 days). Generally, interest is charged on sales receivable in installments with more than six and ten months for domestic and international flights, respectively.

The Company enters into factoring transactions with banks or credit card management companies, in order to obtain funds for working capital. During the year ended December 31, 2019 the Company factored accounts receivable from credit cards with a face value of R\$3,247,722 (December 31, 2018 - R\$2,553,188). Because these receivables are from credit card companies and present a low credit risk, we were able to sell these receivables without any risk to the Company in the event of default by the customers. As such, the accounts receivable were derecognized in full and the discount interest cost recognized in the statement of net income (loss), under financial expenses, for an amount of R\$6,449 for the year ended December 31, 2019 (December 31, 2018 - R\$10,414).

## 9. Aircraft sublease receivables

The Company subleased fifteen aircraft to TAP and the amounts receivable are due as follows:

	December 31,	
	2019	2018
		(Restated)
2019	-	102,660
2020	98,152	102,660
2021	86,657	91,908
2022	47,136	48,897
2023	44,154	42,446
After 2023	64,742	62,237
Lease receivables (gross)	340,841	450,808
Finance revenue (accrued)	(61,337)	(89,070)
Lease receivables (net)	279,504	361,738
Current	75,052	73,671
Non-current	204,452	288,067

As December 31, 2019 and 2018, there were no overdue amounts related to aircraft subleases receivables.

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### 10. Inventories

	December 31,	
	2019	2018
Parts and maintenance materials	288,824	206,729
Catering and uniforms	5,768	9,351
Inventory provision (*)	(33,727)	(15,935)
	<b>260,865</b>	<b>200,145</b>

(\*)As of December 31, 2019, the amount of R\$27,999 refers to the provision related to the acceleration of the fleet transformation.

### 11. Prepaid expenses

	December 31,	
	2019	2018 (Restated)
Insurance premium	47,506	33,385
Aircraft and engine leases	39,989	28,234
Guarantee commission	16,332	20,682
Other	57,792	54,835
	<b>161,619</b>	<b>137,136</b>
Current	139,403	115,453
Non-current	<b>22,216</b>	<b>21,683</b>

### 12. Related parties

#### a) Compensation of key management personnel

Key management personnel include board of director members, officers and executive committee members. The compensation paid or payable to officers and directors services is as follows:

	For the year ended December 31,	
	2019	2018
Salaries and wages	22,187	16,275
Bonus	7,255	7,263
Share-based option plans	29,129	21,508
	<b>58,571</b>	<b>45,046</b>

#### b) Guarantees granted

The Company granted guarantees for some property rental agreements entered into by executive officers. The amounts involved are not material.

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### c) Maintenance agreements

ALAB entered into Maintenance Agreements to aircraft with TAP Manutenção e Engenharia Brasil S/A ("TAP ME"). TAP ME is part of the same economic group as TAP.

The total value of maintenance services acquired by the Company pursuant to such Maintenance Agreements during the year ended December 31, 2019 was R\$17,552 (December 31, 2018 – R\$83,831).

As of December 31, 2019, the amount payable to TAP ME was R\$97 (December 31, 2018 - 5,663) and is recorded under Accounts payable.

### d) Codeshare Agreement

ALAB signed a codeshare agreement with United (a shareholder) and TAP which will provide transport of passengers whose tickets have been issued by one of the airlines and the service is performed by the other.

### e) Transactions with Aigle Azur

On December 31, 2019, the Company recorded in "Prepaid expenses" and "Trade and other receivables", the amount of R\$11,794 (December 31, 2018 – R\$13,330), net of a provision for doubtful debts of R\$5,055 (December 31, 2018 – R\$0).

### f) Loan agreements receivable

On September 2, 2016 the Company entered into a loan agreement with a shareholder. On December 31, 2019 the amount of loan is R\$12,789 (December 31, 2018 – R\$12,042). This agreement bears interest at a rate of Libor plus 2.3% p.a. The term of the contract has been extended and will be paid in full in 2020.

### g) Transactions with Breeze

In December 2019, the Company signed a letter of intent for the sublease of up to 28 aircraft to the Breeze Aviation Group, an airline founded by Azul's controlling partner. The transaction was approved by Azul's shareholders at an Extraordinary General Meeting on March 2, 2020. In 2019 there were no financial flows related to the transaction.

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### h) Transactions with TAP

#### i. Aircraft sublease

In March 2016, the Company subleased fifteen aircraft to its related party TAP. Seven of the fifteen leases had been executed at a time when the market for regional aircraft was higher than when the related seven subleases were executed. As a result, although the Company believes that the rates in these seven subleases represented approximate market rates at the time of their execution, the Company will receive from TAP an amount lower than the amount that the Company has to pay under the related leases.

As mentioned in note 3, in accordance with IFRS 16, an intermediate lessor records the head lease and sublease as two separate leases. The intermediary lessor is required to classify the sublease as financial or operating by reference to the right-of-use asset (and not by reference to the underlying asset).

As a result of this change, the Company reassessed the classification of its sublease agreements as finance leases, based on the remaining term and conditions of the head lease and sublease on the date of the initial adoption, thus derecognizing part of the provision for onerous contracts.

Over the year ended December 31, 2019, amounts received from TAP from the subleases amounted to R\$126,149 (December 31, 2018 – R\$112,046), and amounts paid to the lessors of the related aircrafts totaled R\$140,588 (December 31, 2018 – R\$129,958).

#### ii. TAP Convertible Bonds

On March 14, 2016, the Company acquired series A convertible bonds issued by TAP (the “TAP Convertible Bonds”) for an amount of €90 million. The TAP Convertible Bonds are convertible, in whole or in part, at the option of Azul into new shares representing the share capital of TAP benefiting from enhanced preferential economic rights (the “TAP Shares”). Upon full conversion, the TAP Shares will represent 6.0% of the total and voting capital of TAP, with the right to receive dividends or other distributions corresponding to 41.25% of distributable profits of TAP.

The option is exercisable starting in July 2016. The TAP Convertible Bonds mature 10 years from their issuance and bear interest at an annual rate of 3.75% until September 20, 2016 and at rate of 7.5% thereafter. Accrued interest remains unpaid until the earlier of the maturity date or early redemption of the Bonds.

TAP has the right to early redeem the TAP Convertible Bonds if not yet converted and upon the earlier of (i) occurrence of an IPO, or (ii) 4 years from issuance of the TAP Convertible Bonds provided that TAP should be in compliance with certain financial covenants. The TAP Convertible Bonds will be redeemed at their principal amount together with the accrued unpaid interest.

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The TAP Convertible Bonds, as well as the option to convert them into TAP Shares, were classified as a single financial asset recorded at changes in the fair value through profit or loss, in the amount of R\$61,675 (Note 24) under "Result from related parties transactions, net", classified in "Long-term investments".

### iii. Other Investments

On March 14, 2019, ALAB acquired 6.1% post-dilution economic shares in TAP from Hainan Airlines Civil Aviation Investment Limited ("HACAIL") for US\$ 25 million or R\$96,161. The current shares represents 20.0% and 35.6% of the voting rights and economic rights of Atlantic Gateway, respectively.

On July 1, 2019 HACAIL transferred the shares held in Atlantic Gateway to Global AzulAirProjects, SGPS, S.A.

The investment is recognized at fair value in the balance sheet under "Long-term investments". On December 31, 2019 the gain resulting from this transaction, in the amount of R\$64,710, was fully recorded at fair value through profit or loss, under "Result from related parties transactions, net".

## 13. Security deposits and maintenance reserves

	December 31,	
	2019	2018
Security deposits	152,635	225,230
Maintenance reserve deposits	1,498,898	1,321,490
	<u>1,651,533</u>	<u>1,546,720</u>
Current assets	258,212	144,192
No current assets	<u>1,393,321</u>	<u>1,402,528</u>

Security deposits and maintenance reserve deposits are denominated in US dollars and adjusted for changes to foreign exchange rates. Security deposits are related to aircraft lease contracts and will be refunded to the Company when the aircraft is returned at the end of the lease agreement. Maintenance reserve deposits are paid under certain aircraft leases to be held as collateral in advance of the performance of major maintenance activities and are reimbursable upon completion of the related maintenance event, under certain conditions.

The Company recognized a write-off in the "Maintenance materials and repairs" in the income statements line item for maintenance reserve deposits that are not likely to be reimbursed in relation to aircraft that went through their last maintenance event prior to their return.

The Company replaced some of its security deposits and maintenance reserves deposits with bank guarantees, and was refunded an amount of R\$100,136 and R\$76,931, respectively as of December 31, 2019 (December 31, 2018 - R\$18,125 and R\$106,875 respectively).

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Presented below are the changes in the security deposits and maintenance reserve deposits balance:

	<b>Maintenance reserves deposits</b>	<b>Security deposits</b>	<b>Total</b>
Balance at December 31, 2017	1,078,135	180,992	1,259,127
Additions	317,698	39,593	357,291
Write-offs	(31,132)	(968)	(32,100)
Refunds/returns	(236,987)	(23,175)	(260,162)
Foreign exchanges variations	193,776	28,788	222,564
Balance at December 31, 2018	1,321,490	225,230	1,546,720
Additions	343,727	37,614	381,341
Write-offs	(8,417)	-	(8,417)
Refunds/returns	(210,356)	(113,137)	(323,493)
Foreign exchanges variations	52,454	2,928	55,382
Balance at December 31, 2019	1,498,898	152,635	1,651,533
Current assets	258,212	-	258,212
Non current assets	1,240,686	152,635	1,393,321

## 14. Property, equipment and right of the use assets

Property and equipment and right-of-use assets are mainly comprised of aircraft, engines and aircraft equipment.

As a result of the annual impairment analysis, the Company recorded impairment of non-current assets and assets in use in the amount of R\$2,032,207 in 2019 under the heading “Depreciation, amortization and impairment” (Note 1).

In addition, one aircraft has been classified as held for sale as its carrying amount will be recovered principally through sale rather than through continuing use. The aircraft is available for immediate sale at its present condition and the sale is highly probable. The fair value less costs to sell the aircraft was estimated to be lower than the carrying amount and an impairment loss of R\$16,325 has been recognized. The impaired carrying amount has been transferred to the “assets held for sale” line on the balance sheet.

### 14.1 Property and equipments

During the year ended December 31, 2019, the Company entered into a sale and leaseback transaction on an owned engine. The gain associated with this transaction, which resulted in an operating lease, amounted to R\$6,260 and was recognized in “Other operating expenses, net”.



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During the year ended December 31, 2019, the Company sold one aircraft. The loss associated with the sale of R\$15,854 was recognized in "Other operating expenses, net".

During the year ended December 31, 2018, the Company entered into a sale and leaseback transaction on an owned engine. The loss associated with the sale and leaseback transactions amounted to R\$6,570 and was recorded on "Other operating expenses, net".

During the year ended December 31, 2018, the Company entered into seven aircraft sale transactions resulting in a net loss of R\$144,251, recognized in "Other operating expenses, net".

#### a) Breakdown

	December 31, 2019		December 31, 2018 (Restated)	
	Cost	Accumulated depreciation	Net amount	Net amount
Leasehold improvements	296,728	(78,131)	218,597	93,285
Equipment and facilities	176,814	(106,235)	70,579	49,243
Vehicles	3,614	(1,535)	2,079	2,207
Furniture and fixtures	20,683	(15,119)	5,564	5,029
Aircraft equipment	1,856,138	(941,533)	914,605	1,039,473
Aircraft and engines	850,391	(349,392)	500,999	459,056
Advance payments for acquisition of aircraft	84,578	-	84,578	112,923
Construction in progress	171,839	-	171,839	81,023
	<b>3,460,785</b>	<b>(1,491,945)</b>	<b>1,968,840</b>	<b>1,842,239</b>

#### b) Changes in property and equipment balances are as follows

	Cost			
	December 31, 2018 (Restated)	Acquisitions	Disposals/ Write-offs	December 31, 2019
Leasehold improvements	146,315	124,181	(3,118)	296,728
Equipment and facilities	130,655	48,101	(2,091)	176,814
Vehicles	3,238	376	-	3,614
Furniture and fixtures	18,797	1,891	(5)	20,683
Aircraft equipment	1,378,352	566,152	(72,835)	1,856,138
Aircraft and engines	629,473	146,527	(149,910)	850,391
Advance payments for acquisition of aircraft	112,923	55,649	(45,081)	84,578
Construction in progress	81,023	319,275	-	171,839
	<b>2,500,776</b>	<b>1,262,152</b>	<b>(273,040)</b>	<b>3,460,785</b>

	Accumulated depreciation				
	December 31, 2018 (Restated)	Depreciation for the period	Disposals/ Write-offs	Transfers	December 31, 2019
Leasehold improvements	(53,030)	(25,157)	186	-	(78,131)
Equipment and facilities	(81,412)	(17,265)	687	-	(106,235)
Vehicles	(1,031)	(504)	-	-	(1,535)
Furniture and fixtures	(13,768)	(1,356)	5	-	(15,119)
Aircraft equipment	(338,879)	(143,550)	42,249	-	(941,533)
Aircraft and engines	(170,417)	(33,822)	32,295	-	(349,392)
	<b>(658,537)</b>	<b>(221,654)</b>	<b>75,422</b>	<b>-</b>	<b>(1,491,945)</b>

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### 14.2 Right-of-use – aircraft lease and others

#### a) Breakdown

	December 31, 2019		December 31, 2018 (Restated)	
	Cost	Accumulated depreciation	Net Amount	Net Amount
Aircraft of operating lease	10,901,791	(4,619,858)	6,281,933	3,617,062
Aircraft of finance lease	1,169,636	(916,173)	253,463	924,272
Engines and simulators	484,597	(235,495)	249,102	143,829
Properties	114,167	(64,042)	50,125	54,150
Vehicles	10,238	(7,127)	3,111	2,521
Equipments	20,088	(15,584)	4,502	12,994
Transports	12,065	(12,065)	-	-
Restoration of aircraft and engines	423,194	(178,020)	245,176	171,498
	13,135,776	(6,048,364)	7,087,412	4,926,326

#### b) Changes in right-of-use assets balances

	Cost				
	December 31, 2018 (Restated)	Acquisitions	Disposals/ Write-offs	Transfers	December 31, 2019
Aircraft of operating lease	6,943,314	4,002,981	(42,570)	(1,934)	10,901,791
Aircraft of finance lease	1,289,161	28,455	(75,623)	(72,357)	1,169,636
Engines and simulators	336,731	147,866	-	-	484,597
Properties	105,754	8,413	-	-	114,167
Vehicles	7,999	2,239	-	-	10,238
Equipments	20,767	171	(850)	-	20,088
Transports	-	12,065	-	-	12,065
Restoration of aircraft and engines	283,542	139,652	-	-	423,194
	8,987,268	4,341,842	(119,043)	(74,291)	13,135,776

	Depreciação acumulada					
	December 31, 2018 (Restated)	Depreciations	Disposals/ Write-offs	Impairment	Transfers	December 31, 2019
Aircraft of operating lease	(3,326,252)	(875,170)	42,570	(461,006)	-	(4,619,858)
Aircraft of finance lease	(364,891)	(52,848)	10,019	(536,341)	27,888	(916,173)
Engines and simulators	(192,902)	(38,723)	-	(3,870)	-	(235,495)
Properties	(51,604)	(12,438)	-	-	-	(64,042)
Vehicles	(5,478)	(1,649)	-	-	-	(7,127)
Equipments	(7,773)	(8,427)	616	-	-	(15,584)
Transports	-	(12,065)	-	-	-	(12,065)
Restoration of aircraft and engines	(112,043)	(33,503)	-	(32,474)	-	(178,020)
	(4,060,943)	(1,034,823)	53,205	(1,033,691)	27,888	(6,048,364)

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### 14.3 Right-of-use – maintenance

#### a) Breakdown

	December 31, 2019		December 31, 2018 (Restated)
	Cost	Accumulated depreciation	Net Amount
Checks	201,712	(153,522)	48,190
Checks in progress	23,662	-	23,662
Engines maintenance	1,149,551	(724,012)	425,539
	1,374,925	(877,534)	497,391
			632,900

#### b) Changes in right-of-use maintenance balances

	Cost				December 31, 2019
	December 31, 2018 (Restated)	Acquisitions	Disposals/ Write-offs	Transfers	
Checks	143,866	63,493	(9,971)	4,324	201,712
Checks in progress	-	45,527	(10,546)	(11,319)	23,662
Engines maintenance	779,651	425,482	(67,585)	12,003	1,149,551
	923,517	534,502	(88,102)	5,008	1,374,925

	Accumulated Depreciation					December 31, 2019
	December 31, 2018 (Restated)	Accumulated depreciation	Disposals/ Write-offs	Transfers	Impairment	
Checks	(69,889)	(49,313)	3,101	-	(37,421)	(153,522)
Engines maintenance	(220,728)	(255,043)	42,003	-	(290,244)	(724,012)
	(290,617)	(304,356)	45,104	-	(327,665)	(877,534)

## 15. Intangible assets

#### a) Breakdown

	December 31, 2019		December 31, 2018
	Cost	Accumulated amortization	Net amount
Goodwill (i)	753,502	-	753,502
Airport operating licenses (ii)	82,196	-	82,196
Software	489,904	(238,118)	251,786
	1,325,602	(238,118)	1,087,484
			1,016,556

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### b) Changes in intangible assets balances are as follows:

	Costs				December 31, 2019
	December 31, 2018	Acquisitions	Disposals/ Written-off	Transfers	
Goodwill (i)	753,502	-	-	-	753,502
Airport operating licenses (ii)	82,196	-	-	-	82,196
Software	357,457	132,447	-	-	489,904
	1,193,155	132,447	-	-	1,325,602

	Accumulated amortization				December 31, 2019
	December 31, 2018	Amortization for the year	Disposals/ Written-off	Transfers	
Software	(176,599)	(61,519)	-	-	(238,118)
	(176,599)	(61,519)	-	-	(238,118)

(i) Refers to goodwill recorded in the acquisition of TudoAzul (former TRIP) in 2012. The amount of R\$753,502 represents the excess of the consideration transferred over the fair value of the net assets acquired and liabilities assumed.

(ii) As part of the purchase price allocation of TudoAzul (former TRIP) acquisition, the Company recognized a separate intangible asset for the airport operating licenses. These intangible assets were deemed to have an indefinite life.

### Impairment of goodwill and Airport operating licenses

The Company performed its annual impairment tests as of December 31, 2019. The Company assessed that the most appropriate method for estimating the recoverable amount of the Company's single CGU (cash-generating unit) is by using the income approach through the discounted cash flows method, resulting in the value in use.

In order to determine the book value of the CGU, the Company adds the intangible assets recorded, given that it will only generate economic benefits by using the combination of both.

The assumptions used in the impairment tests of goodwill and other intangible assets are consistent with the Company's operating plans and internal projections over a five-year period, and for longer periods the Company assumed growth rate in perpetuity.

These assumptions are both reviewed and approved by management. The discounted cash flow that determined the value of the CGU was prepared in accordance with the Company's business plan, which was approved in December 12, 2019.

The Company took into consideration the following assumptions:

- Fleet and capacity: considers operational fleet plan, aircraft utilization and capacity per flight;
- Passenger revenue: considers the historical revenue per flown seat kilometer assuming the Company's growth plan;
- Operational costs: considers key performance indicators per cost line, aligned with Company's growth plan as well as macroeconomic variables (as described below);
- Investment needs: aligned to the Company's business plan.

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The Company also considered forecasted market variables such as GDP (source: Central Bank of Brazil), the U.S. Dollar to Brazilian reais exchange rate (source: Central Bank of Brazil), the price of a barrel of kerosene (source: Bloomberg) and interest rates (source: Bloomberg).

The Company prepared a sensitivity analysis considering the variations in the Earnings Before Interest and Tax ("EBIT") margin and the nominal discount rate as shown below:

	Variations		
	1.0%	0.0%	-1.0%
Appreciation (depreciation)			
Discount rate before taxes	9.8%	8.8%	7.8%
EBIT	-9.5%	-10.5%	-11.5%

The result of the impairment test, which includes a sensitivity analysis of the main variables, showed that the estimated recoverable amount is higher than carrying value of net assets allocated to the cash generating unit, and therefore no impairment was recognized as of December 31, 2019.

## 16. Income tax and social contribution

### a) Income tax and social contribution

	For the year ended December 31,		
	2019	2018 (Restated)	2017 (Restated)
Loss before income tax and social contribution	(2,536,265)	(452,926)	414,129
Combined tax rate	34%	34%	34%
Income tax and social contribution statutory rate	862,330	153,995	(140,804)
Adjustments to calculate the effective tax rate:			
Taxable profit on foreign subsidiaries	(3,020)	(21,867)	(13,496)
Exchange differences on foreign subsidiaries	(7,321)	24,917	27,064
Unrecorded deferred tax on tax loss and on temporary differences	(880,375)	(400,187)	56,598
Deferred income tax on tax losses included in the PERT (*)	84,712	-	83,143
Permanent differences	76,958	65,971	(8,006)
Other	(105)	(5,634)	5,885
<b>Total income tax and social contribution expenses</b>	<b>133,179</b>	<b>(182,805)</b>	<b>10,384</b>
Current income tax and social contribution	(2,228)	(11,224)	2,875
Deferred income tax and social contribution	135,407	(171,581)	7,509
	<b>133,179</b>	<b>(182,805)</b>	<b>10,384</b>

(\*) Tax Recovery Program ("PERT")

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#### b) Breakdown of deferred income tax and social contribution

	December 31,	
	2019	2018 (Restated)
Deferred taxes		
On temporary differences		
Provision for tax, civil and labor risks	21,819	27,524
Deferred revenue of TudoAzul program	(148,963)	(132,740)
Aircraft lease expense	1,312,552	1,371,421
Depreciation of aircraft and engines	(48,899)	(33,973)
Exchange rate	(16,498)	(13,397)
Deferred gain related to aircraft sold	19,747	37,628
Cash flow hedge	53,977	52,349
Fair value of TAP convertible bonds	(243,288)	(274,520)
Fair value of other investments	(21,963)	-
Other provisions	116,810	-
Financial instruments	(201,738)	(73,735)
Impairment	989,242	-
Fair value of aircraft	-	(397)
Fair value of slots	-	(27,947)
Other on business combination fair value adjustment	-	(2,707)
Others	73,497	61,993
Net deferred tax (liabilities)	1,906,297	991,500
Net deferred tax assets / (liabilities) on temporary adjustments recognized	(259,785)	(311,391)
Deferred tax assets recognized on net operating losses	17,270	18,180
Net deferred tax assets / (liabilities) – recognized	(242,516)	(293,211)

The Company offsets tax assets and liabilities only when has a legally enforceable right to offset current tax assets and current tax liabilities and the deferred tax assets and deferred tax liabilities related to income taxes levied by the same tax authority.

Deferred tax assets are recognized only to the extent that recovery is probable. As of December 31, 2019 the Company has recognized the amount of R\$ 259,785.

The Company has income tax losses that are available indefinitely for offsetting against future taxable profits, as follows:

	December 31,	
	2019	2018
Net tax losses	1,971,779	1,829,244
Income tax loss carryforwards (25%)	492,945	457,311
Social contribution negative base tax carryforwards (9%)	177,460	164,632

Deferred income tax asset on tax losses at the amount of R\$670,405 has not been recognized as there is no evidence of recoverability in the near future, except for R\$17,270.

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### 17. Loans and financing

	December 31	
	2019	2018 (Restated)
Loans	2,825,749	2,025,607
Debentures	692,407	730,519
	3,518,156	2,756,126
Current	481,227	158,813
Non-current	3,036,929	2,597,313

Interest-bearing loans, financing and debentures are measured at amortized cost, using the effective interest rate method.

#### 17.1. Loans

				Loans		Fair value of designated derivatives (*)	
				December 31,		December 31,	
				2019	2018 (Restated)	2019	2018 (Restated)
	Guarantees	Interest	Final maturity				
<b>Denominated in foreign currency - US\$</b>							
Aircraft and engine acquisition	Chattel mortgage	LIBOR plus "spread" between 2.55% and 3.6% p.a. and fixed interest between 5.37% and 6.07%/ US Treasury + 3.25% p.a.	03/2029	896,232	100,042	(10,971)	-
Working capital (*) (a)	Receivables of Azul and no guarantees	LIBOR plus fixed interest of 0.88% p.a. and fixed of 5.90%p.a	10/2024	1,727,882	1,656,947	(303,507)	(266,404)
<b>Denominated in local currency - R\$</b>							
Aircraft and engine acquisition (FINAME) (**)	Investments and chattel mortgage of aircraft	Fixed between 6.00% to 6.50% p.a. and SELIC plus 5.46% p.a.	05/2025	164,280	192,861	(3,309)	-
Working capital	Bail letter	5.0% fixed p.a and 125% to 126% of CDI	07/2021	37,355	73,376	-	-
Finance lease	Chattel mortgage	CDI plus fixed spread between 3.97% p.a. and 4.91% p.a.	11/2019	-	2,381	-	-
Total in R\$				2,825,749	2,025,607	(317,787)	(266,404)
Current position				233,487	119,676	-	-
Non-current position				2,592,262	1,905,931	(317,787)	(266,404)

(\*) Illustrates the effect of hedges designated for hedge accounting, which are detailed in Note 24. The debt position considering the effects of the hedge can be seen on Note 5.

(\*\*) FINAME are a special credit line from BNDES (the Brazilian development bank).

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### a) Senior notes

The Company issued US\$400 million in unsecured senior notes in October 2017 at 5.875% per year and maturity on October 26, 2024. Interest on the notes will be payable semi-annually in arrears on April 26 and October 26 of each year, beginning on April 26, 2018.

On December 14, 2017, the total amount referring to the Senior Notes was exchanged from Dollars to Reais by means of swap derivative contracts and exchange options to protect interest expenses, and through exchange options to protect the principal amount.

As a result of the implementation of this hedge structure, on April 1, 2018, the Senior Notes are protected against foreign currency fluctuations, up to an exchange rate of R\$4.7500 for US\$1.00, and above this level will be exposed only to the difference between the effective exchange rate and R\$ 4.7500. In addition, the Company will benefit from any upside from the devaluation of the Brazilian real in case the exchange rate is bellow R\$3.2865 for US\$1.00. The options were financed, yielding a total hedged cost of debt of 99.3% of CDI.

The result of the hedge recognized in the "Derivative financial instruments" asset and liability line items and the consolidated debt position including the effect of the hedge is detailed in note 5.

The details of this transaction is following:

Options Structure	Coupon Payments		Principal Payment
Period	Apr/2018 to Apr/2019	Oct/2019 to Oct/2024	Oct/2024
Notional	US\$12 million	US\$12 million	US\$400 million
Put option bought	-	3.2865	N/A
Call option bought	N/A	N/A	3.2865
Call option sold	-	4.7500	4.7500
		<b>Senior notes</b>	<b>Swap</b>
Currency		<b>US\$</b>	<b>R\$</b>
Amount		<b>US\$400 million</b>	<b>R\$1,314,600</b>
Interest		<b>Fixed</b>	<b>Floating</b>
Interest rate		<b>5.875%</b>	<b>99.3% of CDI</b>

### b) Long term loans mature as follows:

	December 31,	
	2019	2018 (Restated)
2020	-	191,437
2021	202,798	59,875
2022	270,899	49,560
2023	258,422	37,016
After 2023	1,860,143	1,568,043
	<b>2,592,262</b>	<b>1,905,931</b>



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### c) The following assets serve as guarantees to secure the financing agreements

	December 31,	
	2019	2018 (Restated)
Equipment and right-of-use assets (carrying value) used as collateral (Note 14)	7,285,497	5,144,219

d) The undrawn borrowing facilities available in the future for setting capital commitments amounted R\$198,714 as of December 31, 2019. Facilities are available exclusively for the funding of Embraer E195 jets engine maintenance costs.

## 17.2. Debentures

	Guarantees	Interest	Final maturity	December 31,	
				2019	2018
Eight issue	Credit cards receivable	CDI + 1.50% p.a.	01/2019	-	40,758
Nine issue	Credit cards receivable	122% of CDI	12/2021	495,548	493,990
Tenth issue	Credit cards receivable	117% of CDI	12/2023	196,859	195,771
Total				692,407	730,519
Current position				247,740	39,137
Non-current position				444,667	691,382

Long term debentures mature as follows:

	December 31,	
	2019	2018
2020	-	296,338
2021	336,580	296,777
2022	89,044	49,131
2023	19,043	49,136
	444,667	691,382

## 17.3 Covenants

As of December 31, 2019 the Company had an outstanding balance of R\$1,366,842 in “loans and financing” subject to financial covenants related to leverage and debt coverage ratios.

Covenants relate to	Ratios measured	Ratios measured
9 <sup>th</sup> issuance of debentures	(i) adjusted debt coverage ratio (ICSD) equal or higher to 1.2; and (ii) leverage ratio equal or lower than 6.5.	Annually
10 <sup>th</sup> issuance of debentures		
Aircraft financing	(i) adjusted debt coverage ratio (ICSD) equal or higher to 1.2; and (ii) leverage ratio equal or lower than 5.5.	Quarterly

As of December 31, 2019 the Company was in compliance with all the covenants related to financial transactions.

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### 18. Lease liabilities

	December 31,	
	2019	2018 (Restated)
Aircraft	11,686,481	8,582,974
Engine and simulators	347,911	254,227
Property	60,648	65,151
Vehicles	7,615	14,668
Equipments	3,089	2,726
Transports	877	-
	<b>12,106,621</b>	<b>8,919,746</b>
Current liability	<b>1,585,233</b>	<b>1,237,909</b>
Non-current liability	<b>10,521,388</b>	<b>7,681,837</b>

The Company entered into sublease transactions of 15 aircraft with TAP and of December 31, 2019 has recorded in "Aircraft sublease receivable" the amount of R\$279,504 (December 31, 2018 - R\$361,738) (Note 9).

The movement schedule for lease liabilities are as follows:

	Weighted average rate (p.a.)	December 31, 2018 (Restated)	Additions	Payments	Interest Accrual	Disposals	Foreign Exchange	December 31, 2019
Right-of-use leases without purchase option								
Aircraft and engines	8.20%	7,725,397	4,153,314	(1,865,472)	726,613	(24,775)	331,057	11,046,134
Others	7.64%	82,545	22,888	(39,008)	8,628	(279)	(2,544)	72,230
Right-of-use leases with purchase option	6.15%	1,111,804	32,188	(269,988)	70,767	-	43,486	988,257
Total		8,919,746	4,208,390	(2,174,468)	806,008	(25,054)	371,999	12,106,621

The leases have an average repayment (in years) are as follows:

	December 31,	
	2019	2018 (Restated)
Aircraft and engines		
Right-of-use leases without purchase option	8.26	7.33
Right-of-use leases with purchase option	4.24	5.22

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The future minimum payments and the present value of the minimum lease liabilities are as follows:

	December 31,	
	2019	2018
2019	-	1,957,371
2020	2,481,457	1,828,394
2021	2,335,363	1,726,072
2022	2,406,701	1,798,733
2023	1,875,308	1,293,654
2024	1,560,055	992,525
After 2024	5,580,166	2,324,962
Minimum lease payments	16,239,050	11,921,711
Financial expenses	(4,132,429)	(3,001,965)
Net present value of minimum lease payments	12,106,621	8,919,746

The following are the amounts recognized in statement of net income (loss):

	Consolidated	
	2019	2018
Depreciation expense of right-of-use assets	(1,034,823)	(973,084)
Interest expense on lease liabilities	(806,008)	(625,906)
Finance income on lease receivables	29,695	33,129
Expense relating to short-term leases	(79,855)	(34,434)
<b>Total amount recognized</b>	<b>(1,890,991)</b>	<b>(1,600,295)</b>

Some finance leases were designated as a cash flow hedge object. The Company used interest rate swaps to convert the post-fixed rate Libor into a fixed-rate exposure, hedging the volatility of future cash flow. Interest rate swaps have the same maturity and common terms as the finance leases.

## 19. Accounts payable

	December 31,	
	2019	2018
Local currency	1,202,166	994,662
Foreign currency	424,411	455,777
	1,626,577	1,450,439

## 20. Air traffic liability

Air traffic liability is comprised of the following:

	December 31,	
	2019	2018
Advance ticket sales	1,408,272	1,099,978
TudoAzul program	685,982	572,474
	2,094,254	1,672,452

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### 21. Provisions

	Return of aircraft and engines	Provision for taxes, civil and labor risks	Provision for onerous contract	Total
Balance at December 31, 2017	479,957	73,198	-	553,155
Provisions recognized	44,199	70,438	-	171,701
Utilized provisions	-	(62,653)	-	(62,653)
Amortization of financial expense	57,064	-	-	57,064
Foreign exchanges variations	87,821	-	-	87,821
Balance at December 31, 2018 (Restated)	669,041	80,983	-	750,024
Provisions recognized	139,652	100,241	1,129,866	1,369,759
Utilized provisions	(333,420)	(93,718)	-	(427,138)
Amortization of financial expense	67,366	-	18,633	85,999
Foreign exchanges variations	28,036	-	6,672	34,708
Balance of December 31, 2019	570,675	87,506	1,155,171	1,813,352
Current	68,888	-	254,553	323,441
Non-current	501,787	87,506	900,618	1,489,911

#### 21.1. Return of aircraft and engines

The provision for the return of aircraft and engines is based on the estimated future costs to be incurred in order to meet the contractual conditions for the return of engines and aircraft maintained under an operating lease.

#### 21.2. Provision for taxes, civil and labor risks

The Company is party to certain labor, civil and tax lawsuits for which appeals have been filed. Based on the Company's external and internal legal counsels' opinion, management believes that the recorded provisions are sufficient to cover probable losses. In addition, the Company has made judicial deposits when required by court.

These provisions are as follows:

	December 31,	
	2019	2018
Taxes	2,024	1,962
Civil	45,067	44,960
Labor	40,415	34,061
	<b>87,506</b>	<b>80,983</b>

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The total amount of claims, which according to management represent losses that are reasonably possible but not probable, for which no provision was recorded are as follow:

	December 31,	
	2019	2018
Taxes	116,074	87,384
Civil	77,360	43,203
Labor	123,119	135,311
	<b>316,553</b>	<b>265,898</b>

- a) Tax proceedings: The Company has tax proceedings related to additional charge of 1% of COFINS on imports of aircraft and engines, in accordance with the provisions of Law 10,865/04, the application of COFINS at a zero rate for imports of aircraft and parts. Management believes that the risk of loss is possible and therefore no provision was recorded for such amounts.
- b) Civil lawsuits: The Company is party to various types of civil lawsuits for compensation claims in relation to flight delays, cancellations of flights, luggage and damage loss, amongst others.
- c) Labor lawsuits: The Company is party to various types of labor lawsuits related to overtime, additional remuneration for undertaking hazardous activities, safety related payments, amongst others.

The Labor Prosecution's Office filed on February 22, 2017 a lawsuit against the Company claiming that it had violated certain labor regulations, including limitations on daily working hours and rest periods. The claim totals approximately R\$66,000 in punitive damages. The lawsuit is currently waiting for hearing and the Company is negotiating an agreement. The Company classifies the likelihood of loss as possible.

### 21.3 Provision for onerous contract

Provision for impairment charge recognized in 2019 that exceeds assets net book value in relation to onerous contracts (Note 1).

## 22. Equity

- a) Issued capital and authorized shares, all registered and without par value

	Company's capital is - R\$	Common shares	Preferred shares
At December 31, 2019	2,243,215	928,965,058	329,568,166
At December 31, 2018	2,209,415	928,965,058	326,631,190

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Each common share entitles its holder to 1 (one) vote in the General Shareholders' Meeting. Preferred shares of any class are not entitled to vote. Preferred shares have: i) priority of reimbursement of capital upon liquidation; ii) the right to be included in a public offering of the Company for a purchase of shares upon transfer of the Company's control for the same conditions as the common shareholders and for a price per share equivalent to seventy-five (75) times the price per share paid to the controlling shareholder; iii) in case of the Company's liquidation, the right to receive amounts equivalent to seventy-five (75) times the price per common share upon splitting of the remaining assets among the shareholders; and iv) the right to receive dividends in an amount equivalent to seventy-five (75) times the price paid per common share.

#### Issuance of shares and issued capital

During the year ended December 31, 2019, the Company issued 2,936,976 preferred shares (December 31, 2018 – 4,877,470) in the amount of R\$33,800 (December 31, 2018 – R\$46,038) in connection with the exercise of stock options.

#### b) Capital reserve

The share-based payment reserve is used to recognize the value of equity-settled share-based payments provided to employees, including key management personnel, as part of their compensation. For the year ended December 31, 2019, the Company recognized compensation expense for an amount of R\$18,894 (December 31, 2018 – R\$22,930).

#### c) Dividends

According to the by-laws of the Company, unless the right is waived by all shareholders, the shareholders are guaranteed a minimum mandatory dividend equal to 0.1% of net income of the Company after the deduction of legal reserve, contingency reserves, and the adjustment prescribed by Law No. 6,404/76 (Brazilian Corporate Law). If the Company has accumulated losses, there will be no distribution of dividends.

Interest paid on equity, which is deductible for income tax purposes, may be deducted from the minimum mandatory dividends to the extent that it has been paid or credited. Interest paid on equity is treated as dividend payments for accounting purposes.

The Company has not distributed dividends for the year ended on exercise ended on December 31, 2019, 2018 and 2017.

#### d) Other comprehensive loss

Changes in fair value of derivative instruments designated as cash flow hedges are recognized in other comprehensive loss, net of tax effects, for a loss of R\$159,261 and R\$153,969 as of December 31, 2019 and 2018 respectively.

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### e) Treasury shares

	Number of shares	R\$
At December 31, 2017	103,000	2,745
Purchased	447,000	12,179
Cancelled	(217,020)	(4,374)
At December 31, 2018	332,980	10,550
Purchased	<b>301,008</b>	<b>12,853</b>
Cancelled	<b>(189,743)</b>	<b>(7,838)</b>
December 31, 2019	<b>444,245</b>	<b>15,565</b>

## 23. Income (loss) per share

Basic earnings or loss per common share are calculated by dividing net income (loss) attributable to the equity holders of Azul by the weighted average number of common shares outstanding during the year ended December 31, 2019, 2018 and 2017, including the conversion of the weighted average number of preferred shares outstanding during the year ended into common shares.

Diluted earnings or loss per common share are calculated by dividing the net income (loss) attributable to the equity holders of Azul, by the weighted average number of common shares outstanding during the year ended December 31, 2019, 2018 and 2017, including the conversion of the weighted average number of preferred shares outstanding during the years into common shares, plus the weighted average number of common shares that would be issued on conversion of all the dilutive potential common shares into common shares.

Basic earnings or loss per preferred share are calculated by dividing net income (loss) attributable to the equity holders of Azul by the weighted average number of preferred shares outstanding during the year ended December 31, 2019, 2018 and 2017, including the conversion of the weighted average number of common shares outstanding during the years into preferred shares.

Diluted earnings or loss per preferred share are calculated by dividing the net income (loss) attributable to the equity holders of Azul, by the weighted average number of preferred shares outstanding during the year ended December 31, 2019, 2018 and 2017, including the conversion of the weighted average number of common shares outstanding during the years into preferred shares, plus the weighted average number of preferred shares that would be issued on conversion of all the dilutive potential preferred shares into preferred shares.

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The following table shows the calculation of income or loss per common and preferred share in thousands, except for values per share:

	For the year ended December 31,		
	2019	2018 (Restated)	2017 (Restated)
Numerator			
Net income (loss)	(2,403,086)	(635,731)	424,513
Denominator			
Weighted average number of common shares	928,965,058	928,965,058	928,965,058
Weighted average number of preferred shares	328,571,282	325,310,485	303,200,642
75 preferred shares (*)	75.0	75.0	75.0
Weighted average number of preferred equivalent shares (*)	340,957,483	337,696,686	315,586,842
Weighted average number of common equivalent shares (**)	25,571,811,221	25,327,251,414	23,669,013,177
Weighted average number of shares based payment	9,865,114	11,530,390	15,446,459
Weighted average number of shares that would have been issued at average market price	6,805,600	6,400,619	9,253,991
Basic net loss per common share	(0.09)	(0.03)	0.02
Diluted net loss per common share	(0.09)	(0.03)	0.02
Basic net loss per preferred share	(7.05)	(1.88)	1.35
Diluted net loss per preferred share	(7.05)	(1.88)	1.32

(\*) Refers to a participation in the total equity value of the Company, calculated as if all 928,965,058 common shares outstanding had been converted into 12,386,200 preferred shares at the conversion ratio of 75 common shares to 1.0 preferred share.

(\*\*) Refers to a participation in the total equity value of the Company, calculated as if the weighted average preferred shares outstanding had been converted into common shares at the conversion ratio of 75 common shares to 1.0 preferred share

## 24. Derivative financial instruments

The Company has the following financial instruments:

		Book value		Fair value	
	Level	December 31,		December 31,	
		2019	2018	2019	2018
			(Restated)		(Restated)
<u>Assets:</u>					
Cash and cash equivalents (Note 6)	2	1,647,880	1,169,136	1,647,880	1,169,136
Trade and other receivables (Note 8)	2	1,165,866	1,069,056	1,165,866	1,069,056
Aircraft sublease receivables (Note 9) (*)	2	279,504	361,738	279,504	361,738
Short-term investments (Note 7)	2	62,009	517,423	62,009	517,423
Long term investments	3	1,397,699	1,287,781	1,397,699	1,287,781
Derivative financial instruments (*)	2	825,924	595,380	825,924	595,380
<u>Liabilities:</u>					
Accounts payable (Note 19)	2	1,626,577	1,450,439	1,626,577	1,450,439
Loans and financing (Note 17)(*)	2	3,518,156	2,756,126	3,504,754	2,742,359
Lease liabilities (Note 18) (*)	2	12,106,621	8,919,746	12,106,621	8,919,746
Derivative financial instruments (*)	2/3	310,190	440,994	310,190	440,994

(\*) Includes current and non-current.



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The carrying value of trade, aircraft sublease receivable and other receivables and accounts payable approximate their fair value largely due to the short-term maturity of these instruments.

### 24.1 Long term Investments

The Company has the following long-term financial investments evaluated at fair value:

	December 31,	
	2019	2018
Bond TAP	1,236,828	1,287,781
Other investments (Note 12 (g)(iii))	160,871	-
	<b>1,397,699</b>	<b>1,287,781</b>

#### Description of significant unobservable inputs to valuation:

The significant unobservable inputs used in the fair value measurements categorised within Level 3 of the fair value hierarchy, together with a quantitative sensitivity analysis as of December 31, 2019 and 2018 are shown below:

#### Non-listed equity investments -Level 3 financial assets

Valuation technique	Significant unobservable inputs	Rate	Sensitivity of the input to fair value (amounts in millions of reais)
Discounted cash flow method	Long-term growth rate for cash flows for subsequent years	December 31, 2019: 2.5% (December 31, 2018: 1.9%)	10bps (2018 – 10bps) increase (decrease) in the growth rate would result in an increase (decrease) in the fair value of R\$24 (December 31, 2018 - R\$3)
	Cost of equity	December 31, 2019: 13.6% (December 31, 2018: 12.2%)	50bps increase in cost of equity would result in a reduction in the fair value of R\$18 (December 31, 2018 - 23).
			50bps reduction in cost of equity would result in an increase in the fair value of R\$20 (December 31, 2018 - 25).

#### Level 3 financial assets reconciliation

Changes in the fair value of the TAP Convertible Bonds is detailed below:

	December 31,	
	2019	2018
Balance at the beginning of the period	1,287,781	835,957
Foreign currency exchange gain (loss) (*)	10,723	48,365
Interest accrual (Note 12.g.ii) (**)	30,184	29,630
Net present value of debt component (Note 12.g.ii) (**)	116,912	13,219
Fair value of call-option (Note 12.g.ii) (**)	(208,772)	360,610
Balance at the end of the period	<b>1,236,828</b>	<b>1,287,781</b>

(\*) recorded in the "Foreign currency exchange, net" in the income statements line item.

(\*\*) recorded in the "Result from related parties transactions, net" in the income statements line item.

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Changes in the fair value of other investments are detailed below:

	December 31,	
	2019	2018
Balance at the beginning of the period	-	-
Acquisition	96,161	-
Fair value of other investments (*)	64,710	-
Balance at the end of the period	160,871	-

(\*) recorded in the "Result from related parties transactions, net" in the income statements line on the acquisition.

## 24.2 Derivative financial instruments

	December 31, 2019		December 31, 2018	
	Assets	Liabilities	Assets	Liabilities
<u>Cash flow hedge</u>				
Interest rate swap contract	-	(7,129)	-	(9,422)
Foreign currency options	338,592	-	246,323	-
<u>Fair value hedge</u>				
Interest rate swap contract	24,057	-	21,813	(1,732)
<u>Derivatives not designated as hedge</u>				
Interest rate swap contract	203,636	(266,439)	93,606	(260,593)
Forward foreign currency contract	203,148	(1,135)	233,638	(74)
Heating oil forward contracts	56,491	-	-	(123,224)
Foreign currency options	-	(35,487)	-	(45,949)
	825,924	(310,190)	595,380	(440,994)

The maturity of the derivative financial instruments held by the Company is as follows:

December 31, 2019	Immediate	Until 6 months	7 to 12 months	1 to 5 years	Total
Assets from derivative transactions	3,354	89,580	75,214	657,776	825,924
Liabilities from derivative transactions	(2,135)	(46,987)	(32,074)	(228,994)	(310,190)
Total financial instruments	1,219	42,593	43,140	428,782	515,734

### Cash flow hedge

Definition	Origin of Risk	Risks designated for hedge	Hedge instrument	Recognition
Hedge of exposure to variability in cash flows attributable to a particular risk associated with a recognized asset or liability or a highly probable forecasted transaction that could affect the Company's results.	Finance lease of aircraft with post-fixed interest rates	Interest Rate (Libor USD)	Cash Flow Swap - swapping post-fixed interest rate to pre-fixed.	<ul style="list-style-type: none"> <li>Protected item: Amortized cost - Liabilities in contra-entry result.</li> <li>Hedge instrument: Fair value - Assets / Liabilities (MtM) in contra-entry profit (accrual) and other comprehensive income (MtM).</li> </ul>
	Senior Notes denominated in foreign currency (only amortization)	Exchange Variation of dolar	Foreign currency options	<ul style="list-style-type: none"> <li>Protected item: Amortized cost - Liabilities in contra-entry result.</li> <li>Hedge instrument: Fair value - Asset / Liability (MtM), in income statement (Intrinsic Value), offsetting the effect of the exchange variation on debt and other comprehensive income in Equity (Value in time)</li> </ul>

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As of December 31, 2019 and 2018, the Company had interest rate swaps designated as cash flow hedges to hedge against the effect of changes in the interest rate on a portion of the finance leases payments and forward foreign currency contract for the protection of the Senior Notes principal denominated in foreign currency and the principal of OPIC in the next 12 months.

On April 16, 2019, the Company designated for cash flow hedge accounting options with notional in the amount of US\$79 million contracted for the purpose of protecting the principal of Opic.

The positions were:

December 31, 2019	Notional amount	Asset position	Liability position	Fair value
Cash flow hedge:				
Loans and financing	40,872	LIBOR US\$	Fixed rate	(7,129)
Foreign currency options	1,614,211	US\$	R\$	338,592
	<u>1,655,083</u>			<u>331,463</u>

December 31, 2018	Notional amount	Asset position	Liability position	Fair value
Cash flow hedge:				
Loans and financing	57,805	LIBOR US\$	Fixed rate	(9,422)
Foreign currency options	1,314,600	US\$	R\$	246,323
	<u>1,372,405</u>			<u>236,901</u>

The critical terms of the swap contracts matched with the terms of the hedged loans. Considering all transactions were deemed effective, the fair value changes on cash flow hedge were recorded in other comprehensive loss against financial instruments in liabilities or assets.

The gains and losses of hedge items (accrual of interest and exchange variation – finance lease and senior notes respectively) are impacted monthly, and are therefore offset monthly by the hedge instruments.

Factors that may influence hedge effectiveness include: i) the time difference between the hedging instrument and the hedged item and ii) the counterparty's credit risk substantially impacts the fair value of the derivative instrument, but not the hedged object (Senior Notes).

Changes in other comprehensive loss (cash flow hedge reserve) are detailed below:

	December 31,		
	2019	2018 (Restated)	2017 (Restated)
Balance at the beginning of the period	(153,969)	(14,688)	(33,785)
Transactions settled during the period	4,389	6,444	6,435
New transactions recognized in income statement	(7,353)	(215,765)	-
Fair value adjustment	(2,328)	70,040	12,662
Balance at the end of the period	<u>(159,261)</u>	<u>(153,969)</u>	<u>(14,688)</u>

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### Fair value hedge

Definition	Origin of Risk	Risks designated for hedge	Hedge instrument	Recognition
Hedge of exposure to changes in the fair value of recognized asset or liability or unrecognized firm commitment.	Finance lease of aircraft with pre-fixed interest rates	Interest rate	Cash Flow Swap - swapping pre-fixed interest rate to post-fixed.	<ul style="list-style-type: none"> <li>Protected item: Fair value - Liabilities in contra-entry result.</li> <li>Hedge instrument: Fair value - Assets / Liabilities in contra-entry result (MtM).</li> </ul>
	Debt instruments denominated in US\$	Exchange Rate and Interest Rate	Cash Flow Swap - swapping US \$ + Spread to reais at% CDI.	<ul style="list-style-type: none"> <li>Protected item: Fair value - Liabilities in contra-entry result.</li> <li>Hedge instrument: Fair value - Assets / Liabilities in contra-entry result (MtM).</li> </ul>

As of December 31, 2019 the Company had fixed to floating interest rate swap contracts with a notional amount of R\$139,702 (December 31, 2018 - R\$163,353). These contracts entitle the Company to receive fixed interest rates and pay floating interest based on CDI.

Adjustment to fair value of these contracts resulted in the recognition of an unrealized gain of R\$24,057 (December 31, 2018 – R\$20,081) which was recorded as financial income. The impact on the statement of net income (loss) was offset by a negative adjustment on the debt hedged. There was no ineffectiveness during the year ended December 31, 2019.

### Derivatives not designated as hedge accounting

#### *i) Forward foreign currency contract*

The Company is exposed to foreign currency risk in USD exchange rate, and therefore entered into NDF contracts registered at CETIP with renowned banks.

During the year ended December 31, 2019, the Company had entered into NDF contracts of US\$426 million to protect itself from currency fluctuations (December 31, 2018 - US\$375 million) that generated an unrealized gain of R\$202,013 (December 31, 2018 – R\$233,564).

#### *ii) Foreign currency options*

On December 31, 2019 the Company also has currency options with notional of US\$195 million (December 31, 2018 – US\$159 million), of which US\$118 million (December 31, 2018 - US\$129 million) are in connection with the Senior Notes hedge and US\$30 million (December 31, 2018 - US\$30 million) in connection to a dollar loan and US\$47 million refers the OPIC operations. As of December 31, 2019, these options generated an unrealized loss of R\$35,487 (December 31, 2018 – R\$45,949).

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### *iii) Interest rate swap contract*

As of December 31, 2019 the Company had interest rate swap contracts in connection with the Senior Notes and the loan of OPIC. Changes in fair value of these instruments resulted in the recognition of an unrealized loss of R\$62,803 (December 31, 2018 - R\$166,987).

### *iv) Heating oil forward contracts*

As of December 31, 2019, the Company also had average NDF contracts on over-the-counter (OTC) Market with eight different counterparties on the local market indexed to Heating Oil forward contract traded on the NYMEX, on monthly tranches, with a notional value of R\$1,244,869 (December 31, 2018 - R\$804,929). The fair value of these instruments amounted to an unrealized gain of R\$56,491 (December 31, 2018 – loss of R\$123,224)

### Fair value of financial instruments

The Company applies the following hierarchy to determine the fair value of financial instruments:

*Level 1:* quoted prices (unadjusted) in active markets for identical assets or liabilities;

*Level 2:* other techniques for which all data that have significant effect on the fair value recorded are observable, directly or indirectly;

*Level 3:* techniques that use data that have significant effect on fair value recorded that are not based on observable market data.

<b>Assets measured at fair value</b>	<b>December 31, 2019</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
<u>Financial assets at fair value</u>				
Cash and cash equivalents (Note 6)	1,647,880	-	1,647,880	-
Short-term investments	62,009	-	62,009	-
Long-term investments (b)	1,397,699	-	-	1,397,699
Interest rate swap contract - fair value hedge option (a)	24,057	-	24,057	-
Interest rate swap contract- not designated as hedge	203,636	-	203,636	-
Forward foreign currency contract	203,148	-	203,148	-
Foreign currency options	338,592	-	338,592	-
Fuel term contract	56,491	-	56,491	-
<b>Liabilities measured at fair value</b>	<b>December 31, 2019</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
<u>Financial liabilities at fair value</u>				
Interest rate swap contract - cash flow hedge	(7,129)	-	(7,129)	-
Interest rate swap contract- not designated as hedge	(266,439)	-	(266,439)	-
Foreign currency options	(35,487)	-	(35,487)	-
Fuel term contract	(1,135)	-	(1,135)	-

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Assets measured at fair value	December 31, 2018	Level 1	Level 2	Level 3
<u>Financial assets at fair value</u>				
Cash and cash equivalents (Note 6)	1,169,136	-	1,169,136	-
Short-term investments	517,423	-	517,423	-
Long-term investments (b)	1,287,781	-	-	1,287,781
Interest rate swap contract - fair value option (a)	21,813	-	21,813	-
Interest rate swap contract- not designated as hedge	93,606	-	93,606	-
Forward foreign currency contract	233,638	-	233,638	-
Foreign currency options	246,323	-	246,323	-
Liabilities measured at fair value	December 31, 2018	Level 1	Level 2	Level 3
<u>Financial liabilities at fair value</u>				
Interest rate swap contract - cash flow hedge	(9,422)	-	(9,422)	-
Interest rate swap contract - fair value option (a)	(1,732)	-	(1,732)	-
Interest rate swap contract- not designated as hedge	(260,593)	-	(260,593)	-
Foreign currency options	(45,949)	-	(45,949)	-
Forward foreign currency contract	(74)	-	(74)	-
Heating oil forward contracts	(123,224)	-	(123,224)	-

- (a) Portion of the balances consist of loans from FINAME PSI, and standard FINAME presented at their value adjusted by the hedged risk, applying fair value hedge accounting rules.
- (b) The Company calculated the fair value of the call option based on a valuation for TAP and binomial model considering the term of option, discount rate and the market volatility of publicly traded comparable airlines, calculated on a 2 years average. The resulting amount of the binomial model calculated in Euros was converted into Reais using the period-end exchange rate. See Note 24.

## 25. Operating revenue

	For the year ended December 31,		
	2019	2018 (Restated)	2017 (Restated)
Revenue			
Passenger revenue	11,198,585	9,029,960	6,985,044
Cargo and other revenue	604,297	430,725	1,054,761
Gross revenue	11,802,882	9,460,685	8,039,805
Taxes levied on			
Passenger revenue	(290,696)	(359,828)	(289,704)
Cargo and other revenue	(69,869)	(43,793)	(45,270)
Total taxes	(360,565)	(403,621)	(334,974)
Net revenue	11,442,317	9,057,064	7,704,831

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## 26. Financial result

	For year ended December 31,		
	2019	2018 (Restated)	2017 (Restated)
Financial income			
Interest on short-term investments (a)	12,462	31,947	50,604
Sublease receivable	29,695	33,129	33,467
Other	29,914	9,446	44,201
	<b>72,071</b>	<b>74,522</b>	<b>128,272</b>
Financial expenses			
Interest on loans (a)	(195,688)	(164,294)	(235,184)
Interest on lease (a)	(732,723)	(606,076)	(484,300)
Interest on finance lease (a)	(73,284)	(75,313)	(72,481)
Interest on factoring credit card and travel agencies receivables	(13,477)	(10,625)	(36,188)
Interest on other operations	(129,954)	(79,822)	(110,375)
Guarantee commission	(30,977)	(26,187)	(24,880)
Loan costs amortization	(12,549)	(23,169)	(36,598)
Amortization of financial expenses	(88,015)	(56,827)	(41,439)
Other	(52,857)	(52,515)	(37,153)
	<b>(1,329,524)</b>	<b>(1,094,828)</b>	<b>(1,078,598)</b>
Derivative financial instruments, net	<b>325,452</b>	<b>298,094</b>	<b>(90,171)</b>
Foreign exchange result, net	<b>(391,905)</b>	<b>(1,306,063)</b>	<b>34,859</b>
Net financial expenses	<b>(1,323,906)</b>	<b>(2,028,275)</b>	<b>(1,005,638)</b>

(a) Interest and expenses on assets and liabilities, in the cash flow statement on December 31, 2019 - R\$1,082,256 (December 31, 2018 - R\$867,132) are registered in this lines.

## 27. Commitments

### a) Commitments for future acquisition of aircraft

The Company has purchase commitments for the acquisition of 94 aircraft (December 31, 2018 – 94), under which the following futures payments will be made:

	December 31,	
	2019	2018
Up to one year	2,815,674	243,857
From one to five years	10,031,346	10,695,827
More than five years	2,625,245	3,960,657
	<b>15,472,265</b>	<b>14,900,341</b>

### b) Letter of credits

As of December 31, 2019, the Company had issued letters of credit totaling US\$529 million (December 31, 2018 - US\$282 million) equivalent to R\$2,134,186 (December 31, 2018 – R\$1,091,744) and bank guarantees in the amount of R\$50,432 (December 31, 2018 – R\$47,676) in relation to security deposits, maintenance reserves and local sureties.

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### 28. Share-based option plan

#### 28.1. Equity-settled awards

##### 28.1.1 First share option plan

The first share option plan ("First Option Plan") of the Company was approved on a Shareholders' Meeting held on December 11, 2009. The plan has a term of 10 years, and no option may be granted after this period.

Exercise conditions of options issued under the First Option Plan require in addition to a vesting period of 4 years, the occurrence of an initial public offering (IPO) of the shares of the Company.

##### 28.1.2 Second share option plan

The second share option plan ("Second Option Plan") was approved on a Shareholders' Meeting held on June 30, 2014, as amended.

Exercise conditions of options issued under the programs of the Second Option Plan, prior to Azul's IPO, require in addition to a vesting period of 4 years, the occurrence of an initial public offering (IPO) of the shares of the Company. Additionally, the options have an 8-year life.

The options issued under the programs of the Second Option Plan, after Azul's IPO, require a vesting period of 4 years. The options have a 10-year life and the exercise price shall equal to the lowest stock price traded in the stock market during the thirty (30) trading sessions prior to the options grant approved by the Board of Directors.

##### 28.1.3 Third share option plan

The third share option plan ("Third Option Plan") was approved on a Shareholders' Meeting held on March 10, 2017.

Exercise conditions of options issued under the Third Option Plan require a vesting period of 5 years. The options have a 5-year life and options can only be exercised within 15 days after each vesting anniversary.

##### 28.1.4 Information about the fair value of share options and expense

The grant-date fair value of share options has been measured using the Black-Scholes model. Expected volatility has been calculated based on historical volatility of airline shares listed on stock exchanges in Brazil and Latin America. The inputs are mentioned below.



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	First Option Plan		
	1 <sup>st</sup> program	2 <sup>nd</sup> program	3 <sup>rd</sup> program
Total options granted	5,032,800	1,572,000	656,000
Date of compensation committee	Dec 11, 2009	Mar 24, 2011	April, 05, 2011
Total options outstanding	303,700	284,000	12,460
Option exercise price	R\$3.42	R\$6.44	R\$6.44
Option fair value as of grant date	R\$1.93	R\$4.16	R\$4.16
Estimated volatility of the share price	47.67%	54.77%	54.77%
Expected dividend	1.10%	1.10%	1.10%
Risk-free rate of return	8.75%	12.00%	12.00%
Average remaining maturity (in years)	-	-	-
Maximum life of the option	Undetermined	Undetermined	Undetermined
Expected term considered for valuation	7 years	7 years	7 years

	Second Option Plan				Third Option Plan
	1 <sup>st</sup> program	2 <sup>nd</sup> program	3 <sup>rd</sup> program	4 <sup>rd</sup> program	1 <sup>st</sup> program
Total options granted	2,169,122	627,810	820,250	680,467	9,343,510
Date of compensation committee	June 30, 2014	July 01, 2015	July 01, 2016	July 06, 2017	Mar 14, 2017
Total options outstanding	861,197	231,638	391,176	494,491	5,606,106
Option exercise price	R\$19.15	R\$14.51	R\$14.50	R\$22.57	R\$11.85
Option fair value as of grant date	R\$11.01	R\$10.82	R\$10.14	R\$12.82	R\$4.82
Estimated volatility of the share price	40.59%	40.59%	43.07%	43.35%	50.64%
Expected dividend	1.10%	1.10%	1.10%	1.10%	1.10%
Risk-free rate of return	12.46%	15.69%	12.21%	10.26%	11.32%
Average remaining maturity (in years)	-	-	0.4	1.5	2.2
Maximum life of the option	8 years	8 years	8 years	10 years	5 years
Expected term considered for valuation	4.5 years	4.5 years	4.5 years	5.5 years	5 years

Changes in stock options are disclosed below:

	Number of stock options	Weighted average exercise price (in reais)
Balance as of December 31, 2017	16,250,687	R\$11.69
Cancelled	(182,388)	R\$18.48
Exercised	(4,877,470)	R\$9.44
Balance as of December 31, 2018	11,190,829	R\$12.55
Cancelled	(69,085)	R\$20.70
Exercised	(2,936,976)	R\$11.51
Balance as of December 31, 2019	8,184,768	R\$12.85

Number of options exercisable as of:

December 31, 2019	2,294,135	R\$13.81
December 31, 2018	2,572,640	R\$11.60

Share-based compensation expense recognized in the statement of net income (loss) during the year ended December 31, 2019 with respect to the share options amounted to R\$12,742 (December 31, 2018 – R\$16,677).

## Azul S.A.

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(In thousands of Brazilian reais, except when otherwise indicated)

### 28.2 Restricted share units

The Shareholders' Meeting held on June 30, 2014 approved a restricted share unit plan ("RSU Plan"). Under the terms of the RSU Plan participants were granted a fixed monetary amount (in Reais) which would be settled in a quantity of preferred shares determined by dividing the monetary amount by the price per share of the preferred shares at IPO.

Exercise conditions of RSUs require, in addition to a vesting period of four years, the occurrence of an IPO of the shares of the Company for the RSUs to become exercisable. At the date of the IPO, the monetary amount of the awards was converted into units based on the IPO date fair value of the preferred shares. The related liability was reclassified to equity in line with the post IPO settlement method.

Subsequent grants are measured based on the grant date fair value of the awards.

#### 28.2.1 Information about the fair value of RSUs and expense

	Date of compensation committee	Total shares granted	Total shares outstanding	Fair value as of grant date (in reais)
1 <sup>st</sup> program	June 30, 2014	487,670	<b>7,934</b>	R\$21.00
2 <sup>nd</sup> program	July 01, 2015	294,286	<b>8,094</b>	R\$21.00
3 <sup>rd</sup> program	July 01, 2016	367,184	<b>75,527</b>	R\$21.00
4 <sup>th</sup> program	July 06, 2017	285,064	<b>122,740</b>	R\$24.17
5 <sup>th</sup> program	August 07, 2018	291,609	<b>205,099</b>	R\$24.43
6 <sup>th</sup> program	August 05, 2019	170,000	<b>170,000</b>	R\$51.65
		<u>1,895,813</u>	<u><b>589,394</b></u>	

Changes in RSU are disclosed below:

	Number of RSU
As of December 31, 2017	809,946
Granted	291,609
Cancelled	(72,303)
Exercised	(299,659)
As of December 31, 2018	<u>729,593</u>
Granted	<b>170,000</b>
Cancelled	<b>(49,748)</b>
Exercised	<b>(260,451)</b>
As of December 31, 2019	<u><b>589,394</b></u>

Share-based compensation expensed recognized in the statement of net income (loss) during the year ended December 31, 2019 with respect to the RSU amounted to R\$6,152 (December 31, 2018 - R\$6,254).

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(In thousands of Brazilian reais, except when otherwise indicated)

### 28.3 Virtual Stock Option Plan

On August 7, 2018, the Compensation Committee approved the Virtual Stock Option Plan ("Phantom Shares"). The plan consists of a remuneration in cash, as there is no effective trading of the shares. There will be no issue and / or delivery of shares for settlement of the plan. A liability is recorded monthly, based on the fair value of the Phantom Shares granted and the vesting period, with an offsetting entry in the income statement. The fair value of this liability is reviewed and updated for each reporting period, in accordance with the change in the fair value of the benefit granted.

The options issued under the programs of the Phantom Shares, require a vesting period of 4 years. The options have an 8-year life and the exercise price shall equal to the lowest stock price traded in the stock market during the thirty (30) trading sessions prior to the options grant approval by the Compensation Committee. Expected volatility has been calculated based on historical volatility of airline shares listed on stock exchanges in Brazil and Latin America.

#### 28.3.1 Information about the fair value of share options and expense

The fair value of share options has been measured using the Black-Scholes model using the informations below.

	Phantom Shares	
	1 <sup>st</sup> program	2 <sup>nd</sup> program
Total options granted	707,400	405,000
Date of compensation committee	August 7, 2018	August 5, 2019
Total options outstanding	560,908	405,000
Option exercise price	R\$20.43	R\$42.09
Option fair value	R\$40.41	R\$25.34
Estimated volatility of the share price	34.00%	38.8%
Expected dividend	1.10%	1.10%
Risk-free rate of return	6.40%	6.40%
Average remaining maturity (in years)	2.6	3.6
Maximum life of the option	8 years	8 years
Expected term considered for valuation	6 years	4.5 years

Changes in virtual stock option plan are disclosed below:

	Number of stock options
As of December 31, 2018	707,400
Granted	405,000
Cancelled	(47,889)
Paid	(98,603)
As of December 31, 2019	965,908

The liability recorded as of December 31, 2019 is R\$11,647 (December 31, 2018- R\$1,596) and is presented in the consolidated statement of financial position under "Salaries, wage and benefits".

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(In thousands of Brazilian reais, except when otherwise indicated)

Share-based compensation expense recognized in the statement of net income (loss) during the year ended December 31, 2019 with respect to the Phantom Shares amounted to R\$13,373 (December 31, 2018 – R\$1,184).

### 29. Subsequent events

- As described in Note 1, on February, 2020, the Company signed a binding offer to acquire the regional airline Two Taxi Aéreo LTDA. ("TwoFlex") for R \$ 123 million.

The offer remains subject to conditions such as completion of the audit, negotiation of a purchase and sale contract, and regulatory approvals.

- On January 28, 2020, the Company announced that it expects to sub-lease 53 Embraer E195 aircraft.
- On February 6, 2020, as announced to the market, the Company signed a Joint Venture agreement with TAP, in order to increase connectivity between the Brazilian domestic market and the European market, the transaction will be submitted for regulatory approvals
- On March 2, 2020, the Extraordinary General Meeting approved the terms of the Letter of Intent for the sublease of up to 28 Embraer E195 aircraft to the Breeze Aviation Group, an airline founded by the controlling partner of Azul with headquarters in the United States.
- In December 2019, a novel strain of coronavirus ("COVID-19") was reported in Wuhan, China. The World Health Organization has declared COVID-19 to constitute a "Public Health Emergency of International Concern."

While we are closely monitoring the potential impact of COVID-19 on our 2020 results, our top priority remains the health and safety of our crewmembers and customers.

Based on the best information available, we are taking the following measures to reduce any potential impact:

- Adjusting international capacity by 20% to 30% to current demand environment
- Sizing domestic growth to new currency environment
- Hiring freeze and launch of unpaid leave of absence program
- Negotiating new payment terms with partners to preserve cash