2Q19 Results Conference Call Transcript
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Speakers

Paulo Kakinoff (CEO)
Richard Lark (CFO & DRI)

Presentation

Operator:

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After GOL's remarks, there will be a question-and-answer session. At that time, further instructions will be given. Should any participant need assistance during this call, please press *0 to reach the operator.

This event is also being broadcast live via webcast and may be accessed through the GOL website at www.voegol.com.br/ir. Those following the presentation via the webcast may post their questions on the platform and their questions will be either answered by the management during this call or by the GOL investor relations team after the conference is finished.

Before proceeding, let me mention that forward statements are based on the beliefs and assumptions of GOL's management and on information currently available to the Company. They involve risks and uncertainties because they relate to future events and therefore depend on circumstances that may or may not occur. Investors and analysts should understand that events related to macroeconomic conditions, industry, and other factors could also cause results to differ materially from those expressed in such forward-looking statements.

At this time, I will hand you over to Mr. Paulo Kakinoff. Please begin.

Paulo Kakinoff:

Good morning, ladies and gentlemen, and welcome to GOL Airlines conference call. I am the Chief Executive Officer, and I am joined by Richard Lark, our Chief Financial Officer.

Richard Lark:

Good morning. Good to be with you all today.

Paulo Kakinoff:

This morning, we released our 2Q figures. Also, we made available on GOL's Investor Relations website three videos with the results presentation, financial review, and brief Q&A.

We are pleased to report earnings per diluted share of R$0.22. Our quarter came in above expectations and we further consolidated our leadership position in the Brazilian market. This was the 12th consecutive quarter in which the Company reported operating profit, reflecting GOL's competitive positioning and financial discipline in the management of its businesses, as well as the efforts and commitment of the entire GOL team. The resilient and integrated work of our team has been the main driver of GOL's superior results.

Again, we improved our operating indicators. In the quarter, GOL's RPK increased 12%, from R$8.3 billion in 2018 to R$9.3 billion this quarter, driven by a 9% growth in the number of transported clients. The higher demand made it possible to recapture the increase in GOL's units cost, optimizing yields through dynamic revenue and fare management. Average yield per passenger evolved 23% quarter-over-quarter, reaching R$0.32.

Supply was up 6.5%, driven by increases of 3% in seats and 1% in departures, as well as average stage length growth. The average load factor was 82%, up near 4 p.p. compared to the same period in 2018.

We continued to drive strong revenue growth. The combination of higher demand and optimized pricing resulted in a record net revenue of R$3.1 billion, an increase of 33% when compared to the 2Q18, a period that we had a reduction in demand due to the national strike of the truck drivers.

Net RASK was R$0.28, a 25% growth. The net PRASK increased 30%, to R$0.26. We achieved an industry leading aircraft utilization of nearly 12 hours per day, which is a global benchmark.

GOL's 2019 guidance is for net revenues of approximately R$13.5 billion. GOL's network serves higher yield routes and is the leader in the domestic client preference with 38% market share. The Company is also leader in the corporate segment with the largest market share of business traffic in Brazil.

We have made adjustments to our fleet plan to accommodate the increased demand for our service and the grounding of the MAX. In the 2Q, we added five leased Boeing 737 800s to our fleet and delayed the scheduled return of three of our NGs. This also offset the effect of the MAX 8 groundings.

As the guidance from Boeing includes an assumption of regulatory approval of the MAX returns to service during the 4Q19, in an abundance of caution, we are executing a plan to cover our capacity needs for the remainder of 2019. We remain committed to the 727 MAX as a core element of our long-term fleet.

With that, I am going to hand you over to Rich, who is going to take us through some additional highlights.

Richard Lark:

Thanks, Kakinoff. I would like to begin by adding my thanks to all of our terrific employees for their commitment and hard work.

Now, I would like to comment about GOL's cost environment. Total CASK ex-nonrecurring in the 2Q was R$0.24, 14% higher quarter-over-quarter. CASK ex-fuel, excluding nonrecurring, increased 12%, mainly due to the 9% appreciation of the USD against the Brazilian Real, the end of the payroll tax relief program, the increase in depreciation due to higher capitalized maintenance on aircraft components including engines, the fleet expansion in eight new aircraft, five net, the 10% rate growth for landing and navigation fees, and provisions for the redelivery of aircraft.

GOL remains the cost leader in South America for the 18th consecutive year. Our fuel efficiency will be slightly impacted by the MAX grounding, while 2Q ASKs per liter increased 0.8% year-over-year. 3Q ASKs per liter are expected to decline year-over-year by 1%. This decline highlights the fuel efficiency of the MAX, which is about 15% better than the 737 NG fleet. Once the MAX returns to service, we expect to get back on track with our desired fuel efficiency gains.

We do not have an update to our contractual delivery schedule with Boeing at this point, which shows 17 remaining deliveries for this year, but we are prepared in the event that the majority of these shift to 2020. We have been working through the delivery delays.

Our margins remain solid. The combination of better pricing, higher demand, and efficient capacity management permitted GOL's recurring operating income to reach R$400 million, with recurring EBIT margin of near 13% in this quarter. Recurring EBITDA was R$815 million, and recurring EBITDA margin reached 26%.

Despite the impacts and operational challenges from the MAX groundings, we still managed to produce strong margins and all-time high quarterly revenues. GOL's 2019 guidance is for EBITDA margin of approximately 28%.

The second point to highlight is cash flow management. The combination of operating cash flow generation of R$873 million in the period and higher cash liquidity improved the Company's financial flexibility. Total liquidity including cash, financial investments, restricted cash, and accounts receivable was R$3.7 billion at June 30, 2019, already considering a debt repayment of R$100 million in the quarter. We estimate that our total 2019 CAPEX will be in the range of R$700 million for operational CAPEX, primarily engine overhauls.

Lastly, we would like to share the continued success of GOL's liability management. The net debt excluding perpetual bonds to last 12 months EBITDA ratio was 3.1x at the end of June 2019. The liability management reduced the Company's cost of debt and improved its credit metrics. Currently, the average interest rate is 7.7% for local currency debt. For USD denominated debt, the average interest rate is 6.2%.

GOL has maintained its commitment to financial discipline, managing the effects of the Brazilian currency through its efficient capacity management and dynamic yield management. For 2019, we expect GOL's domestic capacity growth to be between 5% to 6%, and international to be between 35% to 40%. Non-fuel CASK is expected to be around R$0.14. We have projected the EBITDA and EBIT margins in 2019 at around 28% and 18% respectively. Leverage, measured as net debt excluding perpetual debt over EBITDA, for 2019 should be 2.8x, reflecting our commitment to reduced leverage in the company's balance sheet.

Now, I would like to return to Kakinoff.

Paulo Kakinoff:

Thanks, Rich. In summary, our results this quarter reflect the new competitive levels achieved by our Company. Our commitment to continuous improvement and results has proven the strategy effectiveness of offering a differentiated and high-quality product, while relentlessly focusing on cost efficiency.

We remain committed in offering the best experience in air transportation with exclusive services to clients on new and modern aircraft that connect our main markets with the most convenient schedules. We are focused on prudent management of the balance sheet and liquidity, maintaining cost leadership and continuing as the preferred airline for our clients, while driving sustainable margins and returns for shareholders.

To conclude, we remain optimistic for 2019 with the scenario of demand recovery of the aviation industry in the country and our continuous capacity discipline.

Now, I would like to initiate the Q&A session.

Q&A

Michael Linenberg, Deutsche Bank:

Good morning. Two questions, the first one relates to the Congonhas slots. I guess we did get a ruling out of ANAC, their definition of a new entrant as it relates to the 41 slots. Do you have a sense how quickly they will actually allocate those 41 slots to the new entrants? Is that going to happen very soon?

And also, presumably there will be, in parallel, some sort of legal appeal process since I believe the bankruptcy court basically approved the divestiture or the sale of those slots to you and LATAM, so presumably that will be parallel and ultimately there will be some timeframe when that ultimately is determined. Can you just talk about what is going on there? Thank you.

Paulo Kakinoff:

Michael, thank you for the question. Actually, we have no information on any kind of legal request from any of the new players, so I cannot speculate on it. I believe that those slots will be redistributed and implemented in a quite short period of time. I cannot tell that decisively, but I would assume that by October, latest November, those airlines will be able to deploy their capacity to fulfill the redistributed slots and start the operation. That is my forecast for that subject.

Michael Linenberg:

Great. That is helpful. And then, the second question relates to distribution, the platform that you are on. GOL has historically used the Navitaire system, and as you become a bigger airline and you fly more internationally, there is an argument to be made to move on to maybe a more comprehensive system, whether it is Sabre or Amadeus. What are your thoughts on that? Are you at the point where maybe you have outgrown the Navitaire system and may be considering an RFP to move on to the

Sabre system, Amadeus, etc.? Anything that you could provide us on that front would be great. Thanks.

Paulo Kakinoff:

Michael, now you surprised me, because either you have very good information from inside or you are such a sensitive guy that you could read between the lines.

Richard Lark:

He has a big smile on his face.

Paulo Kakinoff:

Actually, two things I would like to highlight. First of all, we are basically about to conclude an RFP of the PSS system, of the passenger service system. We have the current provider, Navitaire, among the contenders, among the candidates, and technically speaking, we are pretty confident that the current supplier would be able to fulfill our technical requirements.

The system itself, Navitaire's system has developed itself in a way that they are much more sophisticated than they were once the software was firstly conceived. They are somehow catching up on the airlines' needs. Just to tell you, that they came to this RFP process, technically speaking, at the same level of competitiveness than the other companions.

The RFP will be decided on two dimensions: how capable those software, or those systems will be able to fulfill our future requirements, and we have hired an external consultative company, which is fully equipped to drive us through this RFP process, and then help us to understand who is going to be the best provider to our future needs considering our strategic plan; and secondly, the lowest possible cost.

You know how much we care about our cost structure, and mainly about out cost advantage in comparison to the other peers, and that is the king of our decision, because we are not going to compromise our cost structure.

We know that whenever you are talking about PSS, you need to have the right balance between the cost and the revenue opportunities that a more sophisticated and complete systems can provide to us.

So I think that along the following weeks we will be able to communicate to the market the result of such RFP. You are right, we are already for more than 15 months developing this process, which is about to come to an end.

Michael Linenberg:

That is great. Part of the genesis, just from my perspective, is that you have now become so big and to the point that you are now flying into international markets and wanting to more closely align yourselves with Air France-KLM and Delta, combined with the fact that as a much bigger Company you probably have better negotiating leverage, which will help you on the cost.

There are a couple of things that were sort of driving the question. So it sounds like maybe I was reading your mind, but I am glad to hear that we are going to get some resolution on that front, and it sounds like it is going to improve your costs, or at least allow you to maintain low cost going forward. So thank you for that.

Duane Pfennigwerth, Evercore:

Thank you. Just with respect to the revenue guidance for the remainder of the year, obviously very strong in the 1H, how literally should we be taking the implied second half RASM? Is it a function of conservatism or do you actually see RASM rates declining to low single-digit growth exiting the year?

Richard Lark:

Duane, good morning. As you noted, we provided a little bit of a look into how we are seeing the 3Q in terms of load factors and how that would play into both RASM as well as CASM. That number provided there, 11% to 13%, that is what we are seeing. That is what we are seeing, and we just went through an industry consolidation, which had effect in the 2Q, and things are beginning to stabilize now over the next couple of months, where things will settle back in to a more normal situation. We are still seeing expansion.

C couple of points. Number one, if you want to look at it as a glass half full, that does not include the potential for the short end of the booking curve increase if demand hits at the back end of that. In the 3Q18, there was a significant multi-round fare increase. As you will recall, we had the trucking strike in the 2Q, which was mid-May, and it really was not until the end of June that we were able to start to recompose. We were recomposing from the end of June all the way until September, where there were literally around about ten mini rounds of adjustments to get back to that.

So the comparison for the 3Q18 is a harder one, and also, in terms of sequentially, in the 2Q we had a very neutral supply scenario, whereas in the 3Q there is going be a higher increase in supply, both with us as well as the competitive environment.

I will ask Kaki to go in for a couple points there, but that is something that we are keeping an eye on, and it really is kind of an individual level. Our specific capacity plan increases for the 3Q domestic market, which is obviously what your question is coming from. We are in kind of a 3% level, but that is not the case for our competitors.

Paulo Kakinoff:

Duane, to be really straightforward here, we are pretty cautious when we are looking forward to the revenue units. We have now noticed some kind of not rational behavior coming from one of our competitors, and honestly, we cannot understand that, whether it is just a kind of noise in the future inventory seating available. We might be misreading that or, if it is really a not rational behavior, as I said, from one of our competitors.

That made us be pretty cautious regarding our revenue outlook, and also quite defensive. Our behavior on this will remain to be the same one that we have deployed already for almost seven years.

We are pretty conscious of our role being the market leader, and we will incentivize as much as we can the capacity discipline of the market. We are giving that to our investor, a clear position on that, but at the same time, as I told you, we have been pretty cautious because we cannot understand some of the competitors' behavior regarding the capacity to be deployed mainly from the 4Q19 on.

Richard Lark:

From the publicly available data, which obviously you have access to, Duane, everybody else has access to, right now, it is in the system, we are at about a 3% year-over-year capacity increase into 3Q. The overall industry is at around a 12% level. We do not have demand growing at that level.

There is a slide at the end of the Q&A that is on the website where you can see the current expectation for domestic market demand this year is in the range of the 7% area. We have been growing capacity below that to keep equilibrium, stability, and rationality. We have been a leader in that, and then there is one competitor in the group that has 3Q domestic capacity expansion planned in excess of 30%.

You need to look at that as well, and that is obviously reflected in our RASM expectations for the 3Q19, because we are a portion of the market. All three of us are competing head-to-head directly in the majority of the markets, and that number sequentially is also not that much different.

Sequentially, if you go 2Q to 3Q of this year, it is around 10%. If you take what is in the system, the system of all of the companies in Brazil, domestic capacity, it is around a 10% increase in domestic capacity sequentially. So that necessarily will have an impact on RASM. There is no way to avoid that.

But, as Kakinoff said, within that bucket, our number is in the low single-digits. And so we are trying to contribute to the rationality and maintaining the equilibrium, but that does not just depend on us.

Duane Pfennigwerth:

That is helpful. And then, just for a quick follow up, Rich, maybe for you, just opportunities as you see them on the cost structure into 2020. Obviously, the lack of MAX availability is holding you back to some degree this year. There will be some benefit in 2020, but beyond just the return of the MAX. What are the high level opportunities you see on the cost structure into next year? And thanks for taking the question.

Richard Lark:

That is a good question. Obviously, as you mentioned, the main driver of that is our fleet transformation from the NG to the MAX, which has an enormous impact on our cost structure, not just on the 15% reduction in fuel consumption, but also on the higher revenue productivity of our aircraft, given the up-gauging and the increase of stage length from a longer range, which also has a huge cost dilution effect. And some of that definitely, indeed, as you mentioned, is going to get pushed from our 2H into the 1H20, without a doubt.

But we have initiatives across the supply chain, across the capital structure. What I was just mentioning in the previous question in terms of the reduction of our variable costs on the revenue system side of the equation, also in terms of how we sell, but it is really a series of initiatives across the board, which represent for us – and this is in addition to the MAX, potentially, and this is really more over the next 12 months, not necessarily all in this year – about R$500 million of potential positive cost impacts across our entire Company. We continue to work on that incessantly, independently of the fleet transformation process.

Paulo Kakinoff:

And here, I would like also to highlight, for matter of comparison: if you take 2019 as a basis and you pay special attention to the economic results, that allows us to have a quite positive outlook regarding cost for 2020, because we have basically none of the 737 MAX effect reducing our cost happening this year.

You probably know that right after the un-grounding, we are going to be able to get, in a few weeks, something around 20 737 MAX, and that would create a kind of cost reduction shock in some important routes, which would be a quite possible reduced level of cost in comparison to that one deployed by our fleet in 2019.

We had previously considered that we would have that effect happening in 2019. Due to the grounding, that was not possible. So it is pretty positive that we are delivering, as confirmed by the guidance, the previously expected 2019 EBIT margin without getting any kind of benefit created by the 737 MAX, and right after the un-grounding, which is expected to happen by the 4Q19, we are going to have at least 20 aircraft being delivered to our Company in a short period of time. We are quite positive on that.

Richard Lark:

In addition to that, on the fleet side of the equation, on the asset side of the equation, we provided some details this quarter on what we are doing specifically to deal with the MAX situation, which was basically the delays of the MAX and the replacement of those with additional leased NGs.

That activity in itself on the NG side of the equation also allowed us to achieve, through some pretty good negotiations, lower lease rates for that portion of the fleet as well, across those new operating leased aircrafts that are coming into the fleet to bridge that gap here.

In addition to that, one of the things that we had assumed at the beginning of this year, which we ended up postponing because of the MAX situation, was the further modernization of our owned aircraft, which we had been doing since 2016. We still have 11 NGs in the fleet, which we are keeping until the resolution of the MAX situation, but it represents for us potentially R$400 million of income once we get back on that. That will not be happening this year, but we will probably get back onto that horse next year.

There is kind of been a reorganization, a lot of pressure on us to keep our current cost, but we do expect some significant positive catch up next year coming out of the aircraft side of the equation as well.

We tried to give you some visibility into that in the data we provided this quarter as well on the fleet side, but I think an important point there to say is that we were able to negotiate some lower than our current monthly lease rates on the additional operating leased NGs coming into the fleet, and that was positive for us on the CASM side of the equation for this year. That will impact this year.

Duane Pfennigwerth:

OK. Thank you very much.

Dan McKenzie, Buckingham Research:

Good morning. Another question on cost here. Rich, goal is getting some new investors here in the U.S. that are not used to dealing with the foreign exchange moving, so I am hoping you can just talk a little bit about this. If we strip out the 9% depreciation of Brazilian Real in the 2Q, looking at the quarter in a constant currency or like-for-like basis versus a year ago, I am wondering if you could talk about what the CASK ex-fuel and EBIT would have looked like, so core operating performance excluding the FX noise.

Richard Lark:

Thanks for the question. Good morning. The recurring CASK ex-fuel without the FX effect would have shown, 2Q19 over18, a 9% increase versus the 12% increase that we reported with the FX effect. On the operating margin side, the EBIT margin side, the recurring EBIT margin would have been 16% without the FX effect versus the 12.5% that we reported. In terms of EBITDA, the EBITDA would have been 29% without the FX effect versus the 26% that we reported.

Dan McKenzie:

Very good. Second question here, regarding the structural organization of Smiles and the move to discontinue talks, I am wondering if you can elaborate a little bit on that. On the one hand, Air Canada taught us it could take a while, and on the other hand, it seems like it would be nice to get it done, but then I guess there are some crosswinds here. The longer you wait, I am wondering if the cost to bring it in-house might fall just simply on a higher cost to redeem miles. So I am just wondering if you could just help us reconcile some of the cross currents here.

Richard Lark:

Sure. As we announced, the special committee that was created by the Smiles board in December of last year went through a six month process with that committee, which was not successful in reaching a deal, and so we finalized that process.

In the short-term, when I say 'short-term' here, the next couple of months, we are not doing anything specific on that. We have been obviously extremely busy with what has been going on with fleet, with the sector consolidation, with our growth, with our international expansion, with our regional expansion. We have one team here at GOL. It is one kind of consolidated team, and we have been very focused on the opportunities and the priorities, we have been focusing on what you are seeing now.

Having said that, our intention is to complete a reorganization of the capital structure of our Group to increase our sustainable growth rate, as well as to increase our competitiveness in the long-term. And for that, our intention remains to success the take-in of the minority interest of our loyalty program subsidiary.

But the timing right now, I do not have anything specific on that. When we initiated this in October of last year, our thinking was to have everything finalized in maximum over a two to three-year period. So definitely within the window that we specified to do that.

What we are focused on is really with that, the long-term competitiveness of the overall Group in the context of Brazil, South America, and globally, as I think the other question highlighted. GOL today is a global airline in the sense that we are selling tickets all around the world and we have close to 100 airlines and code shares.

So we are looking at the long-term growth rate of the Group, the long-term sustainable growth rate, and the long-term competitiveness. And so we are well within our planning in terms of how we would approach that. Obviously, the sooner the better in terms of tax inefficiencies and other cash uses that could be better optimized there, but that is where we are right now on that.

Dan McKenzie:

Understood. I guess I am just wondering if I can squeeze one last one in here on macro. There is a lot of moving pieces on the macro side, so leaving pension reform, Congress has taken up tax reform, and I know it is early here. It is just in the initial committee stages, but is there a sense that this would be a corporate tax reform, an individual tax reform, or both? I am just wondering if there is any sort of consensus view about the momentum of this potentially in the months ahead.

Paulo Kakinoff:

Dan, we have almost no information there. There are just speculations at this moment. What we have seen is that the Brazilian states, they are more and more sensitive to the damage caused by such high tax burden on the jet fuel, the Brazilian ICMS, and most of them have already implemented new state legislations that are gradually reducing that taxation. But that is the only material thing we have of this tax discussion in the Brazil at the moment.

Richard Lark:

I think also you are referring to what previous administrations had always talked about, sequentially, once pension fund reform would be effected, the next mountain to climb after that would be tax reform, which is a big part of the overall Brazil cost. But, right now the focus is on pension fund reform, which can alleviate a significant amount of cash flow in the government over the next ten years, and also the privatization program, as well, which is really important, but nothing in terms of specific executions happening in tax reform.

Therefore, we continue to work very hard on everything we are doing on the tax side of the equation. For example, this project that we had in the state of Sao Paolo, which reduced the value-added tax on jet fuel by half, from 25% to 12%. That is a lot. That is been approved by the Sao Paolo State Assembly.

You saw the nine regional destinations that we are doing this year are part of that agreement, and that is significant. And we have also done a good job, not just in the state of Sao Paolo, but around Brazil, with similar types of activities designed to have lower taxes in terms of how we are managing our business.

Paulo Kakinoff:

That is something that gives me the opportunity also to highlight one additional resource that we have just deployed, which is pretty common to you guys in the United States, the so-called capacity purchasing agreement.

We have for the first time launched that kind of a structure in the Brazilian South state of Rio Grande do Sul. That allows us to add six new destinations to our domestic network, and we are also supposed to announce new agreements like this in other Brazilian states pretty soon.

That gives us the opportunity to simultaneously enhance our network connectivity at the same time that we are getting access to lower state tax index, which positively affects our performance.

This is a very promising way to further develop not only our network, but the Brazilian airline industry, because we are offering to the customers access to the civil aviation industry, while before they were completely out of that system just because they could not get access to the main routes due to the infrastructure constraint. That would help us also to further reduce on average the tax burden coming specifically from the ICMS tax.

Richard Lark:

As you know well, Dan, the GOL level on the corporate tax side of the equation, we have over R$4 billion of off-balance sheet net operating loss carry-forwards, tax credits. And so, as we go back to being profitable, we have a significant tax asset that we are not using right now. That tax asset, as we utilize it, which could potentially be over the next five years or so, represents about R$1 billion of potential net usage, which is both cash effect as well as earnings effect, and so we have a significant asset that we can use to also help mitigate our corporate taxes.

Dan McKenzie:

That is perfect. Thanks for the comprehensive answers.

Matt Roberts, Raymond James:

Good afternoon everyone. I appreciate the additional color you gave in terms of the MAX and some of your expectations just a minute ago, but I was wondering, could you maybe talk about your thinking in terms of the return date, even though we do not know when that is? Maybe thinking about it in two parts. Firstly in terms of your in-house fleet, how quickly can you get those brought back up, whether it is in terms of maintenance or training, and how long of a lag would you want in order to be able to sell tickets forward? And then, also in terms of the deliveries, what do you think of rate of aircraft that you can induct maybe per week or per month that you could handle based on the current production schedule?

Richard Lark:

That is obviously an issue that you have a large ecosystem that is dealing with that there. We are in the top five operators of MAXs in the world. You have got Southwest, American, United, and each one of those will have different ways of dealing with it, but in our planning, as you mentioned, we covered all of our needs through the high season at the end of this year, which will be pretty much through February of next year. We covered those in terms of identified aircraft that we have already leased, or we would lease or sublease. So we are covered.

We have a lot of flexibility to deal with whatever comes out of Boeing in terms of when they actually get the un-grounding, as well as the aircraft coming out of the factory, as well as those that are in storage. We have flexibility. We could come at it in a bunch of different ways, but we expect that there would be a one to two month process once the un-grounding happens for our aircraft to be accessed and operating in the fleet. I am referring specifically to the aircraft that are with delivery scheduled, the future production scheduled with Boeing.

For the seven aircraft that we have currently grounded, it would be pretty much immediate access because our pilots are already trained on that and we have 100% fungibility on that. We also have the ability through these deals we have done with lessors to also access additional orders that are coming out of other airlines or out of the factory at Boeing, which might not necessarily be on our order, which we could then shift around.

On your other question in terms of on the operating side, in terms of pilots and mechanics and our capacity there, I would just say the same thing. We think there is going to be a one to two month process where we would have to work out. There is a meager linear programming exercise that Boeing is going to have to do with the over 300-or-so aircraft that they have in storage there, and all their clients and the sequencing.

I think it would be highly speculative at this point in exactly how that is going to work, but there is a lot of planning already on that in terms of how it would work when the un-grounding happens.

Paulo Kakinoff:

Actually, since the grounding, every single decision regarding our fleet capacity that we have taken is considering that in any scenario we would put pressure on our pilots, mechanics, and therefore making it possible to sublease seven aircraft through the Brazilian high season.

Those other five that we have already added to our fleet this year, we have given ourselves the opportunity to decide how gradual we intend to reintroduce those planes into our fleet without put us under any kind of additional pressure, which would be pretty much undesired.

GOL was the first airline in the western world to ground the planes, less than 24 hours after the accident, and we took the decision at the time exactly to show to our customers, pilots, and employees that we would compromise neither on safety nor the perception of safety that the Company has always delivered to the stakeholders.

Therefore, I believe that by taking the decision to gradually and carefully reintroduce the planes without any kind of rush, we would just highlight our assets being perceived by the customer like a safety-first company. Therefore, once capacity need is addressed by all those alternatives that we have already built in, there is no reason to rush.

Richard Lark:

We gave you the data. If you go to the recording we made available on the website this morning, we showed you the current plan in terms of NGs and MAXs for this year and next year, and that is already organized. That is already locked in if we want to do it, which is basically another ten NGs in the 2H19, and then next year, basically, we would be receiving 25 MAXs during the course of next year, to finish this year effectively with seven MAXs and finish next year with 32 MAXs, and finishing this year with 106 NGs and finishing next year with 800 NGs. We have be keeping the 700s at around this 24 level to keep our focus on our regional expansion, where we are effectively using those aircraft to compete in those smaller markets.

That is basically our plan in terms of the numbers. How we get there could have a variety of alternatives depending on this linear programming exercise that is going have to be done within the Boeing ecosystem and all the other clients that they have there to deal with once the un-grounding happens.

Matt Roberts:

That is great. Thank you for all that additional color, as well as that chart you referenced in the slide deck. I really appreciate all that. As a follow up, if I could just quickly touch on, you spoke of the 700s for those regional markets. Just a quick one in terms of those regional markets. I know most of them are not launching until 3Q and 4Q, and a lot of them anti-competitive. I think one competitor might have some overlap on one or two of them that they announced, but could you talk about any early read you have on those in terms of forward load factors, or how demand is filling up in those markets? Thanks for taking the questions.

Paulo Kakinoff:

Let me highlight the two different dimensions, and they complementing each other, of our regional strategy. First and most important one is our domestic network expansion being produced by our own fleet. New destinations to be operated with the 737. We have just announced six new ones for this year only. There are more to come from the next year on, and that works in combination with the state's regional strategy through the CPA agreement that I had just mentioned.

We have in Brazil three regional airlines and they are working with us in order to further expand this promising model already implemented and announced last week in Rio Grande do Sul, the Brazilian South state.

So in both directions along the following two years, we are supposed to announce new regional destinations. The strategy is to further enhance our network of activities and consequently load factors, because the sum of those new regional flights, all of them connecting to our main hubs, and then we will have an even more powerful connecting structure than we have today.

Matt Roberts:

Great. Thanks.

Paulo Kakinoff:

Did I answer your question?

Matt Roberts:

It is certainly a good color. Just if you have any early sales on the books, I know they have not really started yet, but maybe how that is looking, if it is in line with expectations, or still ways to go there.

Paulo Kakinoff:

Actually, the sales pattern is following exactly the current market dynamic, nothing higher or below the average pattern in every route. You know that whenever we are starting a new flight, there is a ramp-up curve, and that is exactly what is going on with all of those destinations being recently announced by the Company.

Matt Roberts:

Perfect. Thanks, Kakinoff.

Josh Milberg, Morgan Stanley:

Good afternoon. Thank you very much for the call. My questions relate to the different adjustments that you made to EBIT to get to the adjusted figures this period. I think that this is clear, but my first one is if you could just confirm that you treated the R$192 million provision for aircraft returns as a nonrecurring expense, and additionally tell us what the exact impact of the credits from contractual lease term reductions were?

And then, actually, just to add into that, I also wanted to ask what if any other adjustments you made to get to that adjusted EBIT number, and also whether you recognize losses related to the funding provided to Avianca Brasil and Elliot. Those are my main doubts.

Richard Lark:

The R$192 million for the provision, it was related to four aircraft. As a result of this fleet reorganization that we did because of the MAX situation, that is why that event happened, and so, yes, that is in the nonrecurring bucket there in the quarter, and that also gets matched with a number of about R$133 million, which effectively is a debt reduction. But if you own those contracts and those contracts are going out earlier, that generates a reduction in debt in terms of the IFRS 16 finance lease calculation related to those aircraft returns.

So both of those numbers, the R$192 million provision for aircraft return, as well as the R$133 million number, which is in the other expense line there related to the cancellation of those leasing contracts. Those are the main items. There are some other tax effects in there, but those are the main items that are in that R$80 million net adjustment that we backed out for you guys there in terms of understanding the quarter-over-quarter cost adjustments.

What is not in that number is, we wrote off in the quarter around R$22 million related to about 45,000 passengers that we transported for Ocean Air up until the end of June to help out with the disruption of that company. We are the company that most transported passengers there to help out with that situation.

So there was about R$22 million in the 2Q, that was a written-off provision, if you will, on that. That is the only amount that has been dealt with at this point related to any operational exposure that we have there. We are not going to recover that from that situation there.

The other credits are still there, which is the DIP financing, as well as the participation into credit. That is pending the outcome. We have to wait for the outcome ultimately of what happens there in the legal restructuring process of that company. The next milestone is at the end of August where we would be making a decision or not, but we are following the appropriate rules there.

But going back to the R$22 million, that we treat as operational. You can decide if you want to treat that as a recurring or nonrecurring. That R$22 million is not in the R$80 million. Also, I should say the way that is treated in the accounting, that is a reduction to revenues. It is not an expense item. It is in the recurring revenues, and so there is a R$22 million reduction in revenues in the 2Q related to that air traffic liability that we helped out with on the Ocean Air situation.

Josh Milberg:

OK, Rich, that was a very helpful and clear response. One more related clarification. Just on your full-year 2019 EBIT margin guidance, are you considering the big 2Q provision for the aircraft returns in those numbers or not?

Richard Lark:

Yes, all of our numbers are fully loaded in terms of what we expect. When we talk about what we think about full-year, I think you would be hard-pressed to find a company that provides as much visibility into the future as we do, officially. That reflects what we expect in terms of the business across the board, and if anything is excluded, we will footnote it there to show you how we are keeping.

It is fully loaded for what we expect for the year, the comings and goings as it relates to the aircraft portfolio. That includes what we expect in terms of returns of aircraft, as well as sales of aircraft, and that is also adjusted for this fleet reorganization that we have done over the last couple of months to deal with the MAX situation. That is all reflected in those projections.

Josh Milberg:

Got it. Thank you very much.

Rogério Araujo, UBS:

Congratulations on the strong results. I have a couple questions. First is, there was a distribution of Avianca Brasil's slots in June, except for Congonhas Airport, which was distributed yesterday. My question is if you could provide a comparison of ticket fares sold in July versus those sold in June and May. Did this capacity expansion translate into normalization or partial normalization or not? This is the first question. Thank you.

Paulo Kakinoff:

Actually, that would not be a fair comparison, because July is the high season, and the capacity shock caused by the Avianca Brasil operation termination made the fares to achieve, it is fixed considering the way that we have managed the revenue management structure and regular rules.

You know that when Avianca stopped its operation, they were taking out of the market 50 planes, and they were not replaced by any of the competitors until the end of July because there was not enough time to do so.

Once July was very well sold by the end of May, the net capacity shock did not interfere that much in the July figures because there was not too many available seats able to be sold.

We are going to see that more from August on, but then I can tell you that, considering the current outlook, by October, we are going to have all the capacity previously deployed by Avianca being replaced by the three current incumbents.

That was more of a kind of short effect between August and September, and then from October on, a new equilibrium between capacity and demand will be in place. That equilibrium is pretty much comparable to the one that the market saw in October last year.

So then it was more a kind of short phenomenon happening, pretty much concentrated in August and September, once in July, the high season does not allow us to produce any kind of fair comparison between the two mentioned months, June and July.

Rogério Araujo:

Very clear. Thank you. My second question is a follow up on Josh's questions on the credit that was recognized of R$133 million. Is it related to a cancellation of lease contracts or is it related to a reduction in the length of some of the contracts? Thank you.

Richard Lark:

There are four aircraft that are being returned, and that is different than the original plan. The way that works is that when you make a decision and you have a specific date where you are going to be returning your aircraft, in this case it is in the short term, you have to adjust whatever accounting effects versus what you originally planned to on the expected termination of the contract.

So those effects, both the provisions for the returns, it is very expensive to return aircraft, they have to do a complete engine overhaul, this is a future cash that would be spent, as well as the adjustments you make on the asset to liabilities on the balance sheet, in this particular case, that credit that is realized, that R$130 million is basically the excess of the asset over the liability. You would do a net effect and then you run that through the income statement.

Rogério Araujo:

Perfect. Very Clear. Thank you very much. Have a good day, everyone.

Roberta Versiani, Citibank:

I have a question regarding Avianca Brasil's slots. Even though no foreigners bid on Congonhas, do you see potential for foreign interest in domestic operations in any other Brazilian airport? Also, is that correct to assume that GOL had the highest amount of routes overlap with Avianca Brasil versus the other domestic airlines? Thanks.

Paulo Kakinoff:

Roberta, the second part of the question was understood. Yes, we had the highest overlap ratio with Avianca in comparison to the other peers, but I did not understand the first part of your question. Please, could you repeat?

Roberta Versiani:

Sorry. I wanted to know if you see any potential for an interest in other domestic operations in Brazil, in other Brazilian…

Richard Lark:

Maybe you could just speak a little bit slower, because it is kind of muffled.

Paulo Kakinoff:

If we see any kind of opportunity for what?

Roberta Versiani:

For foreign investors, foreign interest in domestic operations.

Paulo Kakinoff:

Yes, we do. Sorry, possibly it is on loudspeaker here, because it was not so clear. We do see there are opportunities. There are some airports where several interesting slots are available, and they could be fulfilled by a new success, and those are airports with a clear potential, mainly for a low cost, low fare company to get in.

Roberta Versiani:

I am sorry, but which ones? Could you give us more detail?

Paulo Kakinoff:

Clearly, you have Viracopos as one of the airports.

Richard Lark:

Any airport where you do not have slot restrictions, that anybody can go in. The top six airports in Brazil are pretty concentrated, so that includes Congonhas, Guarulhos, Santos Dumont, Brasilia, Salvador. They are very concentrated and there is really no additional capacity there.

We do not have secondary airports in Brazil. Each city generally has an airport. We have over 60 operational airports commercially in Brazil. Of the other 2,000 air facilities we have in Brazil, we have about 60 to 70 that are operated today heavily for commercial aviation. Outside of the top ten, there is capacity, landing rights where anybody could go into those. And they are not the function of demand, as well. Brazil is very concentrated. On these top six airports, you have more than 60% of passenger traffic going in, so it is super concentrated.

Roberta Versiani:

OK. Thanks very much.

Petr Grishchenko, Barclays:

Good afternoon, and thanks for taking my questions. Sorry, I joined the call later so I do not know if it was already answered, but can you provide more color on your debt amortizations for 2020, and any thoughts on the financing options, local market, bonds? You did obviously convert this year, so any thoughts on the liability management will be helpful.

Richard Lark:

As you know, we have been very clear on our plans there. Next year, our plans are to pay the US$30 million term loan, as well as the remaining amount on the 2022 bonds. Those bonds are callable at attractable levels in February of next year, and so sometime between February and August we would be effecting those amortizations, which is significant.

In addition to that, as you know, we transformed the Brazilian Real debentures last year into a three-year amortization schedule. When we started that, we had R$1.1 billion. That was transformed into a three-year payout, which is now the remaining outstanding on that, R$750 million, which will basically be fully amortized over the next two years.

The convertible bond that we issued in two phases that you saw recently; we did another US$96 million gross. The total amount on that raised for us was around US$425 million. That is cash that is now reserved to do these roughly US$400 million amortizations in the 2Q20 or 3Q20 as it relates to the term loan and the 2022 bonds.

The only point I would make on that given your question is that we have zero additional plans of raising any type of unsecure financing in the capital markets. All of our efforts now are focused on secure financing, vis-à-vis the aircraft acquisition plan over the next eight to ten years, where by 2025 we expect to have around 60% of our overall fleet of this new Boeing order of 130 aircraft. About 60% of that would be done through ownership, financing mechanisms where we would be building equity on those aircrafts like we did on our first order; we did 40 aircraft, in this second order, we will do somewhere between 70-80 aircraft through finance lease mechanisms.

Just a final comment. You mentioned the convert. The convert today is actually in the money. So even though that is in the maturity schedule in 2024, because we have the net share settlement mechanism where we can pay either in cash or stock if the convert is in the money and maturity. But having said that, the convert is already in the money.

And so, we view that as equity on the balance sheet, meaning that that is at zero amortization in 2024. So based on what I just described, once we amortize the term loan and the 22 notes next year, the only remaining fixed maturity in our amortization plan will be the 2025 bonds where we have US$650 million to be amortized in 2025.

And so, at this time next year, we will be basically looking at a maturity schedule which has zero unsecured USD maturities until 2025. I think it is important to highlight that, because the endgame on all this liability management we have been doing over the last couple years was basically to get back to that situation, and that will be matched against that US$650 million, we matched against the equity buildup, the off-balance sheet equity build up on the aircraft, which by 2025 will be about US$700 million.

That is why we like to say we are perfectly matched in terms of currencies in assets liabilities, even though those aircraft assets, which are dollarized, traded in USD, and create significant equity value for GOL, we cannot find those on our balance sheet, but how we manage them economically is to have the perfect matching in terms of currencies with assets liabilities on and off balance sheet. We are basically back on track for that, so that is basically how I would answer your question.

Petr Grishchenko:

Great. Thanks a lot for the level of detail, Richard, and best of luck to you guys.

Operator:

Excuse me. This concludes today's question-and-answer session. I would like to invite Mr. Kakinoff to proceed with his closing remarks. Please go ahead, sir.

Paulo Kakinoff:

Ladies and gentlemen, I hope you found our presentation and Q&A session helpful. Our investor relations team, as always, is available to speak with you as needed. Have you all a nice day. Thank you very much.

Operator:

This concludes the GOL Airlines conference call for today. Thank you very much for your participation, and have a nice day.