3Q19 Results Conference Call Transcript
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Speakers

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Richard Lark (CFO & DRI)

Presentation

Operator:

Welcome to the GOL airlines 3T19 results conference call! This call is being recorded and all participants will be in a listen-only mode during the company's presentation. 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 maybe accessed through the Google Web site www.voegol.com.br/ir and the MZiQ platform at www.mziq.com. Those following the presentation video the webcast and the personal questions on the platform and their questions will either be answered by the management during this call or by the global press relations team after the conference is finished. Before proceeding let me mention that forward-looking statements are based on the beliefs and assumptions of goals management and 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. Mr. Paul. Please, begin!

Mr. Paul:

Good morning, ladies and gentlemen, and welcome to GOL airlines conference call! I am Mr. Paul, Chief Executive Officer, and I am joined by Mr. Richard, our Chief Financial Officer.

Mr. Richard:

Good morning. It's my pleasure to be with you all today.

Mr. Paul:

This morning we released our 3rd quarter figures. Also, we made available on GOL's Investor Relations website 3 videos with the results presentation, financial review and the preliminary Q&A. We are very pleased to report that this was the 13th consecutive quarter in which the company reported operating income as well, which had record net revenues, reflecting GOL’s competitive leadership and financial discipline in managing its business. The passionate work of our team has been the main driver of our superior results. Once again, we improved our operating indicators, revenue per passenger kilometer (RPK), increased 12.8%, totaling 11.1 billion, driven by a 15% growth in the number of transported passengers, while available seat kilometer (ASK) growth was

7.6%. Strong passenger demand and dynamic revenue management enabled GOL to offset the increase in operating unit costs. The company achieved average yield per passenger of 31.5 cents of real, an increase of 14.8% year over year; average load factor of 82.9%, an increase of 3.8 percentage points compared to 3T18; and on-time performance of 91.2% in this quarter according to Infraero and data from major airports. We continue to drive strong revenue growth. Net revenue was 3.7 billion reais, the highest ever recorded by the company, and an increase of 28.3% year over year. GOL carried 9.8 million customers in the quarter, a 13% growth over for 3T18, with 9.2 million in the domestic market, 11.4% growth, and 0.6 million in the international market, up 48.6% year over year. Net revenue per available seat kilometer (RASK) was 27.67 cents of real, an increase of 19.2% versus the same period of last year. Net passenger revenue per available seat kilometer (PRASK) was 26.12 cents, a 20.4% growth over 3T18. The net revenue guidance for 2019 is approximately 13.7 billion reais.

We have used our fleet plan flexibility to accommodate the increased demand for our passenger transportation services and to manage to the Max delays and the risk of unplanned and maintenance requirements on some of our engines. In the third quarter we added five leased Boeings 737-800 to the fleet and rescheduled the re-delivery of four of our NGs.

We are working with the assumption of the Max returns to service in our network in December 2019 and, in parallel, we executed a plan to cover our capacity needs for the Brazilian summer high travel season of January and February and subleased 7 aircraft.

To conclude, I would like to extend another thank you to all of our employees. I am very pleased with our company results issued in this quarter and proud of our team who did an amazing job of minimizing the effects of Max delays.

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

Mr. Richard:

Thanks, Kaki! I'd like to begin by also adding my thanks to all of our terrific employees for their commitment and hard work. Now we'd like to comment about GOL's cost environment, unit costs based on cost per available seat kilometer (CASK) excluding non-recurring expenses increased by 5.8 percent from 21.3 cents of real in the 3Q18 to 22.5 cents in 3Q19 mainly due to higher personnel expenses, higher passenger costs and higher depreciation. Fuel costs per ASK decreased 6.7%, consequence of a reduction of fuel taxes, partially offset by additional fuel consumption due to the Max delays. CASK ex-fuel, excluding non-recurring expenses, increased by 14.2% due to a number of factors. 1) a 37.3% increase in depreciation due to the addition of 6 net aircraft in the fleet and a reduction in the pushable life of capitalized engine maintenance and large components; 2) an 18.4% increase in personnel expenses mainly due to an increase in the federal payroll tax rate to 20%, a 3.6% cost of living adjustment, and the hiring and training of 723 new employees due to the expansion of operations, new routes and new bases. And, finally, increases in passenger costs, service provided, sales and marketing and landing fees. GOL has the lowest unit costs in its markets. GOL's 2019 nonfuel CASK guidance is approximately 14.5 cents. Our margins remain solid due to strong cost control and yield management. The company achieved a positive operating result for the 13th consecutive quarter. 3Q19 demand enabled GOL to achieve an EBIT margin of 18.6% in the quarter, the highest since 2006. Operating income (EBIT) was 692 million reais in the quarter, 451 million higher year to year. EBITDA margin was 30.7%, an increase of 11.8 percentage points.

GOL's 2019 EBIT margin and EBITDA margin guidance is approximately 17% and 29%, respectively. Lastly, we would like to show the continued success of our balance sheet strengthening. GOL reported operating cash flow generation of 1.1 billion reais in the quarter, total liquidity was 4 billion reais, 370 million higher in comparison to June 30th, 2019, and 1 billion reais higher than a year ago. GOL's effected 998 million reais of debt repayment. in 2019. The US dollar appreciated 4% in the period against the Brazilian real, causing a net exchange rate and monetary variation losses of 623 million reais. Net debt, excluding perpetual bonds, the LTM EBITDA was 2.9 times as of September 30, 2019, slightly better versus June 30th, 2019, which was 3.1 times.

Now I'd like to return to Kakinoff.

Mr. Paul:

Thanks, Rich! In total, our results this quarter reflect the new competitive levels achieved by our company.

Our commitment to the continuous improvement in results has proven this strategy assertiveness of offering a differentiated and high-quality product while relentlessly focusing on cost efficiency. We remain committed in offering the best experience in the transportation, with exclusive services to customers, 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 the liquidity, maintaining cost leadership and continuing as the preferred airline for our customers while driving sustainable margins and returns for shareholders. And, to conclude, we remain optimistic for the last quarter of 2019. With this scenario of demand recovery, the aviation industry in the country and our continuous capacity and discipline. Now I would like to initiate the Q&A session.

Q&A

Operator:

Thank you! The floor is now open for questions. If you have a question, please press *1 on your touchtone phone at this or any time. If at any point your question is answered, you may remove yourself from the queue by pressing *2. Questions will be taken in the order they are received. We ask that when you post your question that you pick up the handset to provide optimum sound quality. Please hold while we poll for questions.
Today's first question comes from Mr. Duane of Evercore ISI. Please, go ahead!

Mr. Duane:

Hey, thanks! I'm just curious. There were some media reports that the FAA was in Brazil this week. Did GOL have an opportunity to speak with them? And did you get any insights into how they are thinking about our return-to-service timing, not BOEING, but the FAA specifically?

Mr. Richard:

Yeah, Duane. Thanks! We had the annual Alpha conference, the Latin American Airline Association Conference in Brazil this week. A lot of conversations with a lot of the industry players but nothing different than the guidance that we've also received similar to what we received from Boeing, which is an expectation that, during the month of December, the work there would be finalized. So, we have no new information from that specifically. As you know GOL and Brazil ANAC participate in the various committees that are dealing with… on behalf of the airlines and the regulators, very, very actively involved in the process. And our understanding is also that the ANAC, since they are so very closely involved with the process and with what the FAA is doing, that there would be a very short lead time between a decision by the FAA and what the ANAC is doing specifically.

Mr. Duane:

OK. I appreciate that comment and then I'm just following the Delta announcement with LatAm. Can you characterize the level of interest that you're getting from other global airlines and what are the attributes of an ideal partner for goal from here?

Mr. Paul:

Hey, good morning! Kakinoff here. We are now back to our original strategy, which was to not belong to any kind of alliance and make the most out of our own assets. You know that we are holding at the moment 38% of the Brazilian market. We have a huge capability to feed foreigners and also to transport their passengers arriving in Brazil at both international airports, meaning Guarulhos and Galeão, and therefore our behavior from now on is to resume the traditional, the original strategy, which is to codeshare—either codeshare or interline—with the largest possible number of partners, which give us a sizable opportunity, which is ahead of us. I mean, if you consider American carriers coming to Brazil and those potentially who codeshare with us, we could easily double the number of seats available in both ways to these specific customers, North American and Brazilians, they could be either codesharing or interlining with them. And this kind of possibility is on the table at the moment and this is what we are analyzing.

Mr. Duane:

Thank you! And then just for a follow-up there: looking back over the years, are there any product changes or onboard service changes that you pursued as a result of your prior relation—I don't want to say forced into—but are there product attributes that you now have the flexibility to change going forward?

And thanks for taking the questions!

Mr. Paul:

Actually, we had that flexibility before. I mean that we were solely deciding on our other products and services every time. I mean, we are permanently refining our customers proposition and you could expect minor improvements, because the basic product seems to be the most effective and possibly the most successful. If you analyze our market penetration in both larger segments, I mean, the leisure and the business travelers, we are leading the market with a considerable advantage in comparison to the second competitor and we have, in practical terms, two different airlines within the same airplane. We are offering one of the best economy class experiences for a domestic airline, even comparing ourselves to other international carriers and at the same time that we have been able to—last year, giving an example—to sell around 20 million tickets at the average fare of 50 dollars. So, I mean, the product and the services are now delivering the desired balance between low fares and high value customers attractiveness.

Mr. Duane:

Okay. Thank you!

Mr. Paul:

Thank you!

Operator:

And our next question today comes from Mr. Michael of Deutsche Bank. Please, go ahead!

Mr. Michael:

Yeah. Hey, Rich “Kaki”. So, I saw the release out, where you indicated that the Delta agreement was less than a percent of your revenue. But, you know, is that whined down? What are we going to see? Is it going to show up in revenue? Is there anything on the cost side? I know that the relationship went beyond revenue… You know, should we, as we as we think about over the next quarter or two, you know, how does that show up—if at all—maybe it's the minimum, the impact!

Mr. Paul:

First, we value this partnership. We value it. I strongly believe that both companies learn from each other. There were several interactions and we could also contribute with the same amount of knowledge that they had contributed for us. As I mentioned before, Delta had a really small penetration … has a small penetration in the Brazilian market. It is the third among the three main players. We had understood the agreement to that. So, there is only one alternative if not by exclusively operating without that, which is to have partners potentially that are bigger and larger. So, considering the revenue aspects it can only be more meaningful to our company in case that we would either interline or codeshare with these two potential partners. The plus side: there was no either negative or positive effect by codesharing with them. The more we could increase the number of passengers distributed by us in Brazil coming from the United States, we would be naturally enhancing our gain of scales. And, therefore, as a derivative, the cost dilution would be higher. So, the direct costs or regarding structure, there is nothing specific. Richard would like to…

Mr. Richard:

I was going to say. You know, one of our big cash flow items, as we've been doing the overhauls of the engines, has been overhauls and is that our business, you know, is not to our contract with GTL.

And so, to have some more flexibility there… pricing payment terms. We've had a lot of investment in that component. You've also seen that show up indirectly in our results through the depreciation component. And we still have another year to a year and a half phasing out a lot of the engine overhauls. Another thing I would maybe kind of complementing the last question. Over the last couple of years, you know, GOL's made a lot of investment in the product and the service which has been part of the key in becoming the leader in the corporate market. But that also applies to the product we're offering to our international culture interline partners. And that was developed to work with any airline that would value having the premium domestic lead service. And so, if we have our business class passenger flying down from where you are in New York to São Paulo and you want to connect on to Curitiba out of the Guarulhos airport. You can now travel in the GOL corporate class; you have differentiated boarding. And so, that investment that we have made, that this company has made in the product was not only available for … as you're saying, the .3% of our passengers that were coming off a Delta aircraft, they were also applying to the almost 6% of our capacities on our network that are coming from these almost 90 codeshares and interlines, to the extent that's relevant for a partner where they want to have the local premium, you know, kind of "the last mile". The average flight in Brazil is, as you know, an hour and 10 minutes; so, that product is an attribute we add to the product, which makes it, makes us—in addition to the network, which is the key attribute—that makes us very attractive to any partners that want to plug into our to our network in Brazil.

Mr. Michael:

Yeah. That's helpful, Rich. And, just on a second… I know Duane brought up the fact that there was a meeting in Brazil earlier in the week and we had a lot of announcements from some of the regulators and the aviation authority of Brazil. You know, things like talking about 100% foreign ownership and the reduction in the fuel tax, which is obviously helping you, I also believe there was something out about the government talking about doing away with this international passenger tax I think maybe it's on flights within the region to Brazil in year one and you know as it plays out over the next few years it will include longer haul flights to the US. So curious about you know initial take that tax. How much does it help someone like GOL and is that in your guidance for 2020? Do you have some of those tax benefits flowing through and driving that better PNL? If you could just make any commentary around that, since a lot was said this week, would be great! Thank you!

Mr. Paul:

Hi Michael. Yeah. That could be beneficial to our passenger flow considering that we are, specifically for international travelers, our international network, we are carrying more leisure travelers than business. So, they are more price sensitive and 18 dollars tax reduction could be meaningful to them. So, we were not considering that this year, for sure, but whether we are talking about 2020 and the guidance that we have already disclosure today, that is a factor that is already built in.

Mr. Michael:

OK. that's actually very helpful, but it does sound like it could even be more stimulative than we realize. So maybe there's potential on that side. That's good to know. Right! Thanks everybody! Thank you!

Operator:

And our next question comes from Mr. Dan, of Buckingham Research. Please, go ahead!

Mr. Dan:

Hey, thanks! Good morning, guys! A couple of housecleaning questions here. First, the fourth quarter tax act fuel outlook about 4 to 6%. I'm just wondering what the exact bases that you're using from the 4Q18. And then the second one: you know, the slightly reduced EBIT margin outlook for the full year. I'm just wondered if you can clarify that a little bit. Is that just simply a function of reduced ancillary revenue, higher margin ancillary revenue? Is it perhaps higher depreciation or is it less growth? Or is it something else? I'm just wondering if you can clarify the biggest drivers behind that.

Mr. Richard:

Sure yeah. The first question then, the number… Maybe just even before that, you know, we've been providing, where relevant, the quarter for the previous year 2018 and the IFRS 16, so you'll see that the table in the release and also the comparisons in the quarter release are versus a pro forma 2018 for IFRS 16. That's a lot of work to do, but it's all apples to apples. But you're asking not the recurring x-fuel CASK for that kind of… so, the question: the recurring x-fuel CASK in comparison for 4Q18 would be 50.17 for the reference there. So, that's the number that's referencing.

The other question: As you saw, our EBITDA, or guidance, if you will, is performing a little bit better than expected. And we put the EBIT to the operating margin guidance down a little bit. There's really a couple of reasons there: 1) as we highlighted, this year there were some changes in some of the estimates of depreciable life on capitalized maintenance and, so, those depreciation numbers went up a bit. Obviously, no impact on the EBITDA and an impact on the depreciation number which has gone up. But within that, in addition to that the accounting has to be changed, there are two kinds of sub impacts. One is that a chunk of that depreciation is dollarized because they are dollarized assets. So, the higher FX, also has the indirect effect of increasing a little bit the depreciation. And as you know in the year we recently, you know, right now since beginning October and it will kind of run into the beginning of December, we're doing unplanned maintenance on some of our older NGs due to the maintenance pickle fork, which has been wisely widely disclosed. Those unplanned maintenances, a portion of that also goes indirectly into some of the capitalized components of that maintenance.

So, there's also a little bit of pressure there because of that issue on depreciation. But the main effect was the change in the appreciable life. And then there's these two sub effects of the dollar. The stronger dollar and then a little bit the unplanned maintenance on the pickle fork on some of the older 737's, that, as you see, is happening now not just with us, with Southwest and Qantas and some other airlines. And so those increased our depreciation in the Q3 as some of those effects as well as are going to have a little bit higher weight in the Q4 of this year and also next year. So, kind of across the board, 2019 and 2020, we took the EBITDA up by a point. In 2019, the EBITDA is down by point and we kept the 2020 flat. The root of that is the effects I just described to you.

Mr. Dan:

Understood. Ok that's helpful. And with respect to the pickle fork you know I did see the higher cost called out in the release. I'm not sure if there's a revenue loss that you'd want to put with that as well, but, you know, just with respect to my second question here, I'm thinking the return of the Max would drive a nice CASK ASK tailwind next year. Yet that doesn't seem to be embedded in the 2020 cost outlook and I'm just wondering, from where you sit today. You know, as you look at the kind of the guidance for next year, you know, what the bigger cost pressures are that might be offsetting some of the goodness that you're getting from bringing the Max back or if perhaps just there's some conservatism next year in that outlook, just from where you sit today.

Mr. Paul:

The idea of the pickle fork, the revenue impact is already considered as you are to follow the 2019 guidance, revenue wise, it has been minimized by our capabilities to enhance aircraft block time. And also, further increase load factors. So, we were more affected in October due to the short period of time to inform and re-accommodate our customers which made our share curves being affected mainly considering in the short period prior to departure sales. That was the most affected portion of our revenue curve because we had to re-accommodate our passengers, mostly in our own flight. So, from November on and this is basically November because we are considering to have the NG fleet fully operational about the second week of December. In November we had more time to properly re-accommodate the passengers and the booking curve was not so advanced as we had in the beginning of October.

So, I would say that, considering the potential hurt, the potential heat, we were able to mitigate it to a very low level. It shows how resilient this business model is, because to any other line find itself from one week to another with 10% less planes in its fleet, than it was planned and then it was predicted and basically go through that with no noise and not affecting significantly our results. It's possibly one of the best examples on how robust resilient this business model is. Regarding the 20 CASK x-fuel, you can imagine that we have been pretty conservative is in almost everything which touched the Max. I mean even assuming and this is our premise at this moment that the Max might be ungrounded by the third week of December. We are also considering that we will mostly reintroduce those planes in operation and then we can get some CASK upside on top of what has been already disclosed by speeding up the market's reintroduction process. But this is something which cannot be considered as definitive because the Max situation is still somehow unclear.

Mr. Richard:

And then that's the only comment, because there's a lot going on this year. Obviously, last year we had the trucking strike; you guys saw how we dealt with the trucking strike: we only had 12 canceled flights during that period of time, where our competitors each had over 500. And now that's part of the GOL operating model for a variety of reasons. It gives flexibility to deal with a lot of different types of disruption. So, this year we had the capacity shock of Avianca going out of the market; we had these significant delays on the deliveries of the Maxes; and then we've had the unplanned maintenance on some of the old NGs, so we had to re-plan this year. But maybe I'll highlight a couple of facts for you which are in this. On the revenue side, it's pretty difficult to kind of estimate what the net effect of all these things have been because of the power of the capacity shock. But clearly you know the Max delays, which have much greater revenue productivity than our current fleet and as we go into the high season here with the unplanned maintenance on the older NGs and what we've had to do to resupply those and we kind of highlighted this.

If you go to the video presentation on the website, we put a slide in there which kind of shows how we dealt with this resourcing this year. You know 100% we weren't optimizing revenues given what we had to do there with all these issues. Having said that we're delivering what we promised pretty much across the board in terms of revenues, costs and margins and profitability, even better, especially on the cash flow and deleveraging. So, how we get there: there's a lot of complexity on that, let alone on the revenue side. So, not only there has been a revenue impact but it would be highly complex to specifically specify it at this point in time. We also need to wait till we get on the other side of the Max and the pickle fork. And then when the dust settles, we can provide some clear visibility on what we may or may have not lost on that in terms of revenues. Now on the cost side, a couple of things especially as relates to the exact same issues as we can talk about 2020. This year we would have… given our fleet plan on the Max, what we expected to have in operation already in the second half of this year was really the second half of this year starting in July with the bulk of our orders would start to come in, that would have already provided us a 3 to 5% lower, ceteris paribus lower unit cost. We didn't get that this year. We're gonna catch up next year.

So, the plan is to be back by the end of next year to at least 32 Maxes at the end of next year in the fleet. And so, we're definitely gonna have the benefit of that which, you know, in our calculations, was probably a little bit in excess of that 5% potentially. Once we get back to that clarity on the Max deliveries. That's kind of one point overall. There's some additional components as well just as you compare 2019 to 2020. One is that the significant reduction that we had in the ICMS jet fuel tax. We'll have the full year effect of that next year. This year it was just a half year effect, 'cause it really kicked in in the second half. Another component that can affect this is that this year we've continued to have very strong demand out of business. And we built up close to a 40% market share in that market during the 2nd and 3rd quarters of this year. And we'll get the full effect of that next year. And so that will also be something that is a slight difference from 2019 to 2020. Another point, we still have 11 owned NG aircraft in our portfolio now, which have around at least hundred million dollars off the balance sheet equity. If we didn't have the situation with the with the Max and these other issues this year, we would have continued our monetization plan of those aircraft. So, we postponed that. Well, we plan to reinitiate that at some point next year.

And then finally as I was mentioning previously in the question on depreciation, we had some additional, or higher, if you will, depreciation costs this year on NG's because of the Max situation. So there's been a variety of effects this year, some of which we've highlighted as non-recurring, but there's a bulk of these that they're not non-recurring because they're part of the general operations of the business that we have today, but many of them will either reduce or be optimized next year as we get back on the track of transforming the fleet. So, I just wanted to maybe highlight some of those points and cover kind of all the ground that can be impacting our revenues not just this year but also next year. Also, the impact on the 2020 CASK overall, not just the CASK x-fuel, but also on the fuel side of the equation. And also, as we highlighted an additional point: right now, we're having a higher consumption on the volume side of jet fuel because we're operating NGs versus plan in lieu of Maxes and that will also come in next year. And I think what better clarity and all these things probably in January of next year. And so, when we discussed Q4 most likely at the end of February we'll be able to give you guys better specificity on all of these things as it relates to 2020. We're providing a lot of guidance there, a lot of details to help people understand how we're thinking about managing the business. It's guidance. By definition, it's guidance. It's what we're thinking about. It's not conservative, it's not aggressive, it's the guidance.

So, that's what we're working towards and, as we have better clarity on a variety of these uncertainties right now, we'll be able to maybe answer some and give some more clarity granularity on what's going on with both the unit revenues and the unit cost as we transition. But as Kaki mentioned right now there is still some uncertainty about when exactly we're going to have to get back on track with the fleet transformation. And so as soon as we have that that's going to be a trigger for us to assume some more definitive positions on a lot of these questions, we're getting not just today but you know for a couple of months now. We're going to keep getting them for another couple months, I suspect.

Mr. Dan:

Understood. Thanks so much for the comprehensive answer!

Operator:

Our next question today comes from Mr. Savi of Raymond James. Please, go ahead!

Mr. Savi:

Hey, thanks for the time! Kaki, you had mentioned, in the recording, the fleet flexibility and the Mac being in the high season probably not much of an issue, but it sounded like you should be able to get the Max that's grounded up in the air pretty quickly. I know some of the U.S. carriers have talked about kind of one to two months to get them ready and back up. I'm wondering if you could talk a little bit about: 1) We do get the recertification. How quickly the Max onsite can come back on and how many Max can you get delivered from Boeing? How many in any given month is Boeing going to deliver?

Mr Paul:

I think early for the question. Actually, in Brazil, we are under our own regulator rules, which is called ANAC. ANAC has already publicly positioned itself saying that they would act in accordance with the FAA. So, we do expect that kind of simultaneous release of all agencies at the same time. So, I don't predict any kind of disturbance in that process once the FAA say that the plane is allowed to be ungrounded. Nevertheless, what we have done to guarantee our recapture of all revenue opportunities along the high season is to recompose our structure, to rebuild our fleet availability by bringing more NGs to operation, more NGs to our fleets, though we are having now for the high season only 6 planes from Transavia. You know that traditionally we are sending them from 4 to 6 planes every year during the European summer, and now, this year, we are also having the benefit of this long lasting partnership and bringing these planes at the same lease cost, the same lease rates that we were asking them to operate during the Brazilian high season. Also, we have leased 5 other short-term aircraft; by "short term" I mean 1 to 2 years. And through these movements we are now forecasting our high season without the need for the 737 MAX being operational again. If this would happen, we can further enhance our operational performance and also address opportunities, like additional flights or new frequencies on the most demanding routes during the high season. But the guidance that you have already in place for the 2019 and 2010 does not depend on the Max return along the busy and high season. We took that action in order to avoid that any postponement is this ungrounding process, which would jeopardize our particular results.

Mr. Richard:

I'll just accompany what Kaki said: as Maxes are ungrounded prior to or during the high season, be it December, January or February. We can take it. Normally, during the high season we have a lot of extra flights we put into certain places in our network or extra frequencies for those flights especially from mid-December until mid-February. Carnival is late this year, at the end of February. So to take advantage of the Brazilian summer season where you've got a lot of traffic especially intensively on Friday through Monday going to the beaches and other places on the weekend so we can easily put those into the network and generate some additional revenues taking advantage of the Brazilian high season. If for some reason that would go beyond the Brazilian high season, in other words, we go beyond February.

As you know during the March April May low season, the way we do our network management during the course of the year, intrayear, we vary our capacity down around 10%. So, we'll put 12 or 14 aircraft on the ground in maintenance roughly in the second quarter anyway. So, if that extends, we will then be putting the Maxes flying during the low season and then taking another 12 to 14 aircraft out of service anyway for activity and maintenance. So, we've covered that gap to bridge us through our high season and there would be some upside there if the Max is freed up to be producing revenues sooner. But through the tools we use, for example, as Kaki mentioned, the sub leasing tool we have some of these winter lease tools we have we've covered our risk on that to be able to satisfy demand which is as you've been following across the board in Brazil not just in our sector now but in other sectors as well is starting to pick up from an economic perspective. And that will provide some pretty buoyant demand for air travel here over the next couple months.

Mr. Savi:

That's helpful. Thanks! And during the 2020 outlook there was kind of mention of loyalty revenues being a bit softer. What's driving that?

Mr. Richard:

There's a couple of things. This shouldn't be news! I think it was probably a year ago that as demand for air travel isn't picking up and given good rational capacity management, there is a countercyclical component in different components of the business, just because of how it works: one is the derivative of the other. So, that's one. Then, the other component that we highlighted as well a couple of quarters ago was the expectation of increasing competition. I would say increasing non price competition resulting from the reintegration and merger of the various loyalty program activities that LatAm has, as they finalize their process, I think it was in sometime in the second quarter. That's basically happening now in terms of higher competition in that space as well as higher demand from—you can see it reflected in the load factors, not just GOL but the sector as a whole. So, a combination of those factors creates a little bit of a tradeoff, but that's the normal part of that business. You know Smiles just celebrated its 25th anniversary. We've been with that business since 2007, so 12 years now. That business also has competitive and cyclical aspects, which is the symbiotic nature of those different businesses that we have.

Well, on a separate card now, standalone basis, you see the effects of that which effectively is the cost of goods sold of our loyalty program increases in this part of the cycle. And on the cost side of that business, if you will, which is consolidated on our results, because what's cost for one is revenue for the other. But then on the revenue side there is higher competition in the point space. So that has already started to have an impact in the margin, but this is something I think that we highlighted over a year ago in terms of what we expected from a group perspective and it seems to me all that's happening along the lines and timing that we expected. So, in our business, in our consolidated results we're seeing those effects as well in our consolidated results versus previous expectations so there's a slight adjustment there. And the expectations of the revenues that are generated from that ancillary non-passenger revenue, and also some adjustments on the minority interest as well in the expectations over the next couple of quarters.

Mr. Savi:

Thanks for reminding us! I forgot that. My bad!

Just a housekeeping question, a last one, on the non-recurring, on the operating income the 78.9 million, could you provide a little clarity on what's included in that?

Mr. Richard:

Yeah, there's a variety of items in there and we're just separating these out there that are really onetime effects not related to disruptions specifically. But there are some effects there related to the Max. There are also some effects there related to some investment, short term investments we've made in consulting and other projects to deal with things that are really not at the airline operating level, they are more at the holding company level. And then there is a chunk there that relates to the return of the aircraft which generally ends up being provisions when we make decisions on returning aircraft specific dates or so on where we're maintaining provisions on those, but as we've been changing around a lot, the actual return dates, because of the Max situation and because of the unplanned maintenance of the NGs, that has created a little bit more, let's say, volatility on our ability to get accurate provisions on what we expect on the aircraft return costs. And so, all those are in there it's kind of divided among all of those, as I was saying before. In terms of what’s specifically related to the Max and the NG issues, I think that's something that, when we get on the other side of the delays on the Max, we can provide some more clarity on what that ended up costing us, from an expense as well as cash flow perspective.

But there is obviously a little bit of effect there in the system on additional types of expenses that we have on us, because of having to reschedule the network and replan flights, take flights out of the network and reorganize, we have to pay a certain cost. Now that we have to deal with reimbursing passengers and things like that, a variety of costs there they come in as it relates to the overall business that would not have happened if we were not reorganizing the maintenance schedule and the aircraft return schedule and dealing with the re-planning of the fleet. This year, you can see this in the chart in the presentation that's in the video, if you were to do a… by the end of this year, when all the dust settles, this company will effectively have rescheduled intrayear over 40 aircraft to deal with the various types of asset disruptions that we've had to deal with that and so that's equal to about one third of our fleet. And so that creates a lot of attrition in all the components of the business and it has impacts, secondary and tertiary impacts on a lot of different components. We've also had to spend additional money to keep chugging along in terms of producing our revenues and profitability. So, there is a weight in there that's weighing on that those results. We've tried to separate out some of that, which is clearly identifiable, but there's other effects that are in the recurring past which are also related to that. So that's what I would say at this point in time but I think when we talk about Q4 at the end of February, I think we'll be able to provide some more clarity on that in terms of what our 2020 unit costs are excluding these effects, some of which have been excluded as non-recurring and then others which are creating the attrition on the overall unit cost.

Mr. Savi:

That's helpful color. Thank you!

Operator:

Our next question comes from Mr. Stephen of City. Please, go ahead!

Mr. Stephen:

Good day, gentlemen! And thanks very much for taking my questions! You've already provided some very comprehensive detail on top line, what have you, and I really appreciate that. While you've already answered my inquiry, but just a tiny follow up, if I may, on Dan Mackinsey's question from earlier. When I think about you 4Q at least heading into 4Q year on year, thinking about unit revenue, clearly, you guys mentioned the Max and having to rebook passengers. When I think about the normalized year on year trend. Is there any stays length related inputs I should factor in there?

Mr. Richard:

Are you saying just in general on Q4 or a specific item?

Mr. Stephen:

Yeah. Just broadly speaking on Q4 when I think about recognizing that there's a great deal of noise with the Max, as you guys have highlighted. How should I think about, to the extent you're allowed to tell me, or what I should consider from a stay's length adjusted, excuse me, average stays length adjustments on year on year. I saw you were launching a third international flight for example to the US.

Mr. Richard:

Oh sorry. You're asking specifically on stays length. Is that what you said? OK. Yes, that would be around 1,100 kilometers for the Q4. That would be the expected stay length. There was a whole lot of change on that, because we've slowed down significantly the rollout of the international destinations because of the delays on the Max deliveries and so, especially in the routes where it was specifically required the Max for that mission such as Miami-Orlando. We are rolling out still, as you saw, shorter all destinations such as Lima from Brazil, and Orlando from Manaus, and we're doing our Cancun flight. So that expansion there, which will have an impact on the cost, as I was saying, that will get caught up as soon as we have the Maxes working again. So, the Max we have grounded, the missions that they can be deployed on specifically related his longer haul markets, which we he said in our in our planning, can happen as early as the Q1 of next year but not before. So that's not going to be expanding until that point in time.

Mr. Stephen:

This is very helpful, Rich. And just one other final very quick question. You know it seems kind of once again at least in news flow that elements of the government seem to continue trying to entice foreign carriers to line service, but it really seems like nobody is patting with. I mean, aside from competition consumer and other laws that a foreigner could find onerous, is my view on that reasonable? Or are you hearing anything different in terms of what that competition landscapes are and how it's evolving?

Mr. Paul:

Hello! Kakinoff here. The market is now open. I mean, there are several new rumors, things like this. You probably know, we should remember that GOL always support the foreign capital lift to the market, which was finally approved, showing that we have appreciation for the competition and no fear to compete. I can't tell you at the moment whether some of these rumors will be translated into the concrete movement. They might be, but I think that we are well prepared for any kind of competition. They have mentioned too many times the low cost carriers, and when you compare our current CASK—you have this this data available in our pack, which you can compare our current CASK with the international benchmarks, there is more room to have somebody else coming to Brazil and operate at a lower level which is somehow protecting our business model. So, they could come. There's a lot of marketing of this kind of subject that competing exactly in the same scenario, in the same environment. I don't think that, sustainably, a competitor could create or produce a much lower CASK than ours. It is so. So, I mean that might be more harmful to some of our competitors than to ourselves.

Mr. Stephen:

Oh, very helpful, Kaki. I will leave it there. Thanks very much.

Mr. Paul:

Thank you!

Operator:

And our next question today comes from Mr. Rogerio of UBS. Please, go ahead!

Mr. Rogerio:

Hi Richard! High Kakinoff! Thanks for the opportunity. Couple of questions here. First, if you could provide an update on the industry deployment from GOL and also the other players in upcoming months! What does GOL expect in terms of competitive environment in upcoming quarters? And also, second question, a follow-up on Delta kind of relationship there. If I am not mistaken, there was also some relationship on the maintenance front, and could you give some color on how that agreement worked? I think it also had some working capital related, especially payables, on that maintenance, if I'm not mistaken, if you could provide more color on how that agreement worked and how could this change now! That's my question.

Mr. Paul:

Hi Rogerio. Thank you very much for the questions! Regarding capacity, I believe that the industry will continue to behave rational. We have cleat about one specific player, which is Azul. We know that they are updating some of the fleet, but also there is a portion of this capacity being added by them which is not so clear, the motivation behind it, but in an overall perspective and considering that, assuming that the Brazilian economy next year could reduce the GDP between 2 to 3% growth, I think that all the capacity projections that we have got access is done on the price and also the competitors saying, plus our own, I think that the industry will have another healthy year with regards to the capacity rationality.

Mr. Richard:

We manage our business to try to grow at or below a sustainable growth rate. I think that's the key to create value for our shareholders. That's what our shareholders want. And you know we're growing at that rate which is right around or probably a little bit higher than the historical elasticity, but you know we have a little bit of repressed demand, it's catching up. So, it's kind of our normalized capacity growth rate. We're kind of around a three times GDP growth rate here. You know let's say normalized throughout the year from a seasonal perspective which I see now as around what you could call 7% in the domestic market.

I think it's important to separate domestic from international because they have different impacts and so you know the growth rate of Brazil on this next part of the cycle should be around that 7%, which is around the 2,5 times the GDP elasticity. You could have a little bit more than that in the short term, maybe as much as 8. I'm saying kind of throughout the year. In the next couple months because of seasonality. Well you know we're probably going to see low teens grow. Those are the demand numbers that are given to us. And our job is to match capacity with that. I think domestically, if you look at networks and model networks on Brazil as a whole, you see similar capacity expansion out of LaTam Brazil, and Azul is about 3 times that.

The law of supply and demand applies to all of us. Then you'd have to ask if on the demand side you're a glass half full guy which I know you are Rogerio or your glass half empty guy. I mean if you're a glass half full guy, you know the incremental inventory that's coming into the market, dovetailing with better economic growth, you know I've been hearing some people talk about potentially 4% GDP growth in Brazil next year, but it's possible that we could have a very nice demand uptick to match that capacity growth with no impact on the yield environment. But if that doesn't happen it would have to be something that would pay for that excess capacity or the capacity growth would have to slow down. You know I think we're only going to see that in the second quarter of next year. As you know we're going through the high season now which is going to go through February.

So, I think that quarter of next year will be a test of that in terms of how each company and the industry and how we all manage through that and that'll be a function of what the demand environment is in the second quarter of next year. But recently and I said recently last couple weeks last maybe as much as two months there has been a lot of leading indicators that are showing a pickup in domestic market demand in Brazil and a lot of sectors retail, real estate, retail banking, things like that. Would you guys also look at and obviously it's early days on that you know Brazil is also making a lot of progress on say the Brazilian government’s making a lot of progress and what they've been promising in terms of reforms and you know so there's more positive indicators currently than have been maybe in the first half of this year. Our perspective on that, especially six months out, we're matching our capacity growth with what's going on in demand. It's the largest airline in Brazil. We're the biggest determinant of that. We don't manage our business based on market share, we're managing based on sustainable growth, self-finance growth, earnings growth, things like that, and that's how we're thinking about it at this company. And that's what I say on that.

On your second question on the company, what was said previously on our maintenance work, a large portion of what we do on the maintenance side is done with Delta Tech Ops. And one of the effects of the unwinding of our partnership there would give us much more flexibility to bid out those that business to other maintenance providers and give us a little bit more flexibility to negotiate better terms. Delta Tech Ops has been an important partner for us on the means of our CFO engines. If I'm not mistaken, the last numbers that I looked at on Delta Tech Ops, we were the largest customer of Delta Tech Ops in terms of the amount of annual revenues we generate for that business. I think I expect they will continue to be a supplier of ours, but we don’t necessarily have the same constraints on us vis-a-vis seeking other deals. Given the large volume of business that we have every year out in the market which is going to continue for the next couple of years. We're also not in the engine maintenance business, but we are also continuing to invest in our own maintenance business which today is focused mostly on airframes and is also now providing services to third parties. Now we have clients in our portfolio now including leasing companies that are doing maintenance with us in our 1.6 million square foot maintenance center in the Confins airport in Minas Gerais. We still have to third party our engine units, at the same time we're also advancing in terms of developing our own standalone MRO facility, which is already generating revenues. We're certified by the FAA to maintain a variety of aircraft and we're also pursuing that.

I think the way to think about that as you think about GOL is that GOL IS going to have more flexibility to maximize the economics, we have on what is still our largest capex item per year. That will not be present this year, but could be present in our numbers next year as we define what we're doing regarding the unwinding of that partnership in the coming period

Mr. Rogerio:

Pretty clear. Thanks very much! Appreciate it!

Operator:

Ladies and gentlemen, as a reminder, if you'd like to ask a question please press * than 1. Today's next question comes from Mr. Peter of Barclays. Please, go ahead!

Mr. Peter:

Hi! Good afternoon, gentlemen! Thanks for taking my question! Obviously, a lot of them were already answered, so I guess I'll just follow up on Delta-Latam partnership. The way it seems, you evaluated the partnership from revenue standpoint; obviously, it was not very significant, but I guess one would argue that you know Delta played a much more important role particularly during the downturn. And I guess now in, I’m not sure, next August, I believe, is a good example for that. So, from a credit standpoint, I think there is a much bigger significance of partnership beyond just the percentage of revenue. With that, I just wanted to understand, is it fair to say that you are looking for a partner or at least considering entering a new partnership? And, if so, if you can give us any time, any expectations, it will be very helpful.

Mr. Richard:

Thanks! But, Peter, just to understand, what do you mean "from a creditor perspective"? What? Maybe a little bit more so I understand to answer the question. What do you mean "from a creditor perspective"?

Mr. Peter:

Well, during the last recession, clearly Delta provided some support for the company. And, as I mentioned, that is 200 million alone that they guarantee a while back, is an example for that.

Mr. Richard:

So, I think you're specifically talking about the term loan where we raised money from U.S. high yield investors at a cost of 6.5% per year with the Delta Coast signing where Delta got the guarantee of smile shares in counter guarantee. That's why you referring to?

Mr. Peter:

Precisely.

Mr.Richard:

OK. Well, if you say you see our bonds today are trading at near 6.5%, you know, GOL's unsecured bonds, and those were paying probably about 325 basis points over Delta risk. And those investors they are not GOL investors. I mean, we don't even… Those are Delta. Those are, if you will, investment grade US investors, who don't invest in GOL, don't invest in high yield bonds. They're not really part of our capital structure. And we pay significant admin fee to Delta on that. That's why. It amortizes next year in August. That's the maturity. It's called the part of February and we've already worked to resort to cash to get rid of that. That has a significant negative impact on our earnings. And I don't see why you would do that as a negative, but I think what your question is… because that's not what we would be looking at in a commercial partner credit support. That's not what we'd be looking for. As Kaki was saying as well, you know, we're focused on maximizing our revenues and profitability. And we've got the largest network in Brazil with a lot of complementarity, connectivity and synergies with a variety of partners. You see we continue to announce codeshares and interlines almost every month. We've got close to 90 now. And so that's a commercial issue. In terms of strategic partners, no. I mean we have nothing planned in that respect nor does it really play into our strengths in terms of what we can offer to the potential partners at this point. I don't think from a creditor perspective as you're saying, that we are coming to the box as a positive in name only, in that respect. I think, from our perspective, it would have to be based on specific strategic reasons to do that, which can take a while to develop and take a long term, it would not be necessarily a short-term component. As you know, our space, our larger space, which is as you know South America, is also going through a bit of a reorganization in terms of how the alliances are communicating with South America, and that's kind of work in progress. And I don't know if you want to comment on anything on that. I mean they are separate issues. You know, the commercial, the maintenance and what we might do strategically are really separate issues. As you say, we have a network today which is generating over 6% of our revenues from close to 90 codeshares and interlines, and in the case American United already working with them on an interim basis for a while. And I think we're going to continue to pursue that. I think what you're referring to when there are a lot of ways back in 2015 that when GOL, very responsibly we know, when the economy contracted 3.5% in 2015 and then ended up contracting another 3.5% in 2016. You know in the third quarter of 2015, GOL developed a plan to reduce the size of its assets and balance sheet, and sold 9 aircraft, returned another 20. It took 29 aircraft out of their fleet in a 6-month period and it needed some short term liquidity to do that, a majority of it came from our controlling shareholder family, and then a small portion of that came out of that from Delta, in terms of the equity capital that was put in the company back in October of last year, but the main support came out of the controlling shareholders and Delta, as a partner, teamed up with the Constantino family and helped out with that and definitely provided a lot of support and their experience of having gone through a right sizing a while ago and that had huge value in what GOL was doing in terms of navigating that really tough environment and they provided the cosigning along with our holding company on the term loan.

That was an enormous help to get liquidity into the company at that time and all that liquidity, the equity that came in, about 150 million bucks as well as the 3-million dollar term loan and some other things that was used to kind of get the wheel going to in addition to the 9 aircraft that GOL sold out of its own equity, you know, that whole pot was used to downsize the company, if you will, very early on in the cycle. If you think of it, it was at the very beginning of that drop. Now we had some other companies that we know they didn't do it that are doing it now, arguably three years late and some didn't make it. And so that was an enormous help that came from a shareholder perspective very much in a partnership way, at that time, that helped effect that downsizing.

But GOL today is generating positive not just operating cash flow, net cash flow, but also there's some cash equity there. You saw this year up until September, we've advertised close to a billion reais of debt. We've got about 4 billion reais of cash on the balance sheet.

So, all this is kind of within this plan to get us to the appropriate capital structure which we are at right now, which should improve on next couple of years, given the cycle, but then the bigger picture I think the company today is very well prepared for the next part of the cycle which is more of a secular growth cycle. And then I think 3, 4 years from now, I think that question you're asking is perhaps the more and more relevant question in terms of how prepared we are in terms of balance sheet and competitivity to deal with what will be the next outside or at some point, 4 or 5 or 6 years from now and so on. But at this point in time we have more reasons to just focus more on operations than on the other side of our fleet transformation and then potentially Azul may or may not want to do, in terms of participating in any strategic work in Brazil or a larger work you know in the South American region. But at that time would kind of contextualize that to you in terms of how we're thinking; that's kind of how we're thinking about it today. But I think there still are some other pieces to the puzzle to kind of evolve over the course of next year. I think before it becomes clearer on things like industry structure and competition and things like that. So, we're not running in any external direction at this point in time we're just focused on operations, on balance sheet on everything that we've been talking about and trying to be prepare the company the best we can right now to take advantage of next year in terms of growth, fleet transformation and international expansion, things along those lines.

Mr. Peter:

Great! Thanks for a very comprehensive response! And just a follow-up on one thing you mentioned, the maturity or maturity next year. Did you get it right? Are you basically ruling out, issuing like tapping the bond market, either locally and nationally, to refinance that? Or what you’re saying is you're just not going to raise that in the first half of next year? I just want a little bit better understanding of that.

Mr. Richard:

OK Good question. That's a good question. We have the cash resources. If we wanted to exercise the calls over next year and do that with cash and effect not just a gross debt but a net debt reduction, we can do it if we want. So, specifically as relates to the term loan, no. We would not be raising any. We're not refinancing that. No! Currently as we said today, we have no plans to be doing anything in the fixed income markets next year either in dollars, in yen, in euros or in reais. No plans to do that because we’d have to use some proceeds to do that as much as about raising cash. If we're going to raise cash, increase cash on the balance sheet, it would be through non fixed income mechanisms such as internal cash generation or equity, and we don't have any plans to raise equity. So, most of our cash building up is going to be come from operations. Having said that, as an airline, as a CFO for an airline, my part of the job is always looking at ways to reduce the cost of capital, improve the balance sheet and so always monitoring opportunities. I think the convertible bond we issued this year was an example of that. For us, it was an equity transaction with some additional cash on the balance sheet was a way of monetizing the volatility in our stock and creating a new source of capital for the company. So those kinds of things we're always looking at but right now we have no plans specifically, but we have to be always kind of looking at ways to improve our balance sheet strength and financial flexibility and so we're always looking at things along those lines.

Right now, no: we have no plans. And so, the plan of the long term would be within our policies which is in terms of what we want to have in terms of maximum leverage, lack minimization and liquidity measures. Everything is going to be done in the context of that. And so, whatever we do, of course it's not going to put the company in a constrained liquidity situation. Based on our plans and so on, you can expect that we're going to continue to maintain or improve our credit ratios because as you know we have an objective from a lack optimization perspective getting the company back to a B minus in the near term. And so that's going to guide us on how we approach capital structure and how we do what will effectively end up being the last major piece of liability management that we've been doing over the last three years. Once we get on the other side of the term loan, now the next fixed maturity in U.S. dollars is 2025, which is the bonds we have trading outstanding which are trading a little over 6.5% in the market.

And, as you know, we're almost finalized, next year we will be finalized with advertising our Brazilian real debentures. Just a comment on that: Brazilian interest rates also are at record lows. It really doesn't exist: a true high yield fixed income capital market unsecured issues in Brazil! And so, it doesn't exist for us the opportunity to link that out on maturities in the local market’s capital markets. For companies like us in Brazil, non-investment grade, really only exists the bank market which are short term maturities, for us maximum three years. So, even though Brazilian in real borrowing cost today is around 6.5% and rising versus around 6% in dollars overall, there is not a viable market for us to be buying long term US dollar denominated aircraft assets financed in a long-term market in Brazil. That market doesn't exist. If it were to develop, if the Brazilian fixed income capital market were to develop over the next year or two that is something we could potentially look at. But right now, it doesn't exist, so we're not looking at it got it.

Mr. Peter:

Thank you very much! And best of luck to you guys!

Operator:

And our next question today comes from Mr. Lukas of Morgan Stanley. Please, go ahead!

Mr. Lukas:

Good morning, Kakinoff and Rich! Thanks for taking my question and congratulations on the results! I just wanted to check in if there are any developments on a potential incorporation of Smiles and overall corporate restructuring. If you have any color on timing and potential structures, that will be great. Thank you.

Mr. Richard:

Sure. What is the second part of the question? Sorry!

Mr. Lukas:

What structures if you have any color on timing or any potential structures that you will be thinking on incorporating Smiles.

Mr. Richard:

Oh yeah. Our attention is to effect to take in. We're in the process of that. The Smiles board and their Governance Board are working on a variety of issues over the last couple months and so we'll have no news on it today. As soon as we have news, we would communicate that, but we're basically at this point kind of in a holding pattern here, awaiting discussions that are happening at the Smiles board level. We would like to move forward on that, but we have to wait for it for now, for some of the discussions that are happening at that level. And so, I have nothing to say on that at this point in time, but our intentions continue the same, the same reasons. It's very important. It’s not just a question of cash flow and results optimization; it's really a question of long term competitivity and the maintenance and improvement of not just the value of the GOL product but also the Smiles product. It's very important that we move forward on that, but as soon as we have any news on that we will communicate that. I don't expect it's going to be in the short term here, given all we're waiting on. Smiles has to finalize before we can move forward on what we want to do.

Mr. Lukas:

That makes a lot of sense. Thank you very much!

Operator:

Ladies and gentlemen, this concludes today's question and answer session. I'd like to invite Mr. Kakinoff to proceed with his closing remarks. Please, go ahead, Sir!

Mr. Paul:

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

Operator:

This includes the GOL airlines conference call for today. Thank you very much for your participation and have a nice day!