Q2 2019 Earnings Call

Company Participants

- Paulo Sergio Kakinoff, President and Chief Executive Officer
- Richard F. Lark Jr., Executive Vice President, Chief Financial Officer and Investor Relations Officer
- Richard Lark, Chief Financial Officer
- Unidentified Speaker

Other Participants

- Analyst
- Daniel Mckenzie
- Duane Pfennigwerth
- Josh Milberg
- Michael Linenberg
- Petr Grishchenko
- Rogerio Araujo

Presentation

Operator

Welcome to the GOL Airlines Second Quarter 2019 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. (Operator Instructions).

This event is also being broadcast live via webcast and may be accessed through the GOL website at www.voegol.com.br/ir and the MZiQ platform at www.mziq.com. 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 the 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 statement.

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

Paulo Sergio Kakinoff {BIO 5160310 <GO>}

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

Richard F. Lark Jr. {BIO 427746 <GO>}

Good morning. Good to be with you all today.

Paulo Sergio Kakinoff {BIO 5160310 <GO>}

This morning, we released our second quarter figures. Also, we made available on GOL's Investors Relations website, three videos with the results presentation, financial review and brief Q&A. We are pleased to report earnings per diluted share of BRL0.22. 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 RPKs increased 12% from BRL8.3 billion in 2018 to BRL9.3 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 fair management. Average yield per passenger evolved 23% quarter-over-quarter reaching BRL0.32. 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 nearly 4 percentage points compared to the same period in 2018. We continue to drive a strong revenue growth. The combination of higher demand and optimized pricing resulted in record net revenue of BRL3.1 billion, increase of 33% when compared to the second quarter of 2018, a period that we had a reduction in demand due to the national strike of the truck drivers. Net RASK was BRL0.28, a 25% growth. The net RASK increased 30% to BRL0.26. 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 BRL13.5 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 second quarter, we added five leased

Boeing 737-800 to our fleet and delayed the stellar return of three of our entities. 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 fourth quarter of 2019, 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 737 MAX as a core element of our long-term fleet.

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

Richard F. Lark Jr. {BIO 427746 <GO>}

Thanks Kaki. I'd like to begin by 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. Total CASK ex-non-recurring in the second quarter was BRL0.24, 14% higher quarter-over-quarter. CASK ex-fuel excluding non-recurring increased 12%, mainly due to the 9% appreciation of the U.S. dollar 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 aircrafts five net, the 10% rate growth for landing and navigation fees and provisions for the redelivery of our 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 second quarter ASKs per liter increased 0.8% year-over-year, third quarter 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 don't 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've 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 BRL400 million with recurring EBIT margin of near 13% in this quarter. Recurring EBITDA was BRL815 million and recurring EBITDA margin reached 26%. Despite the impacts in 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 BRL873 million in the period and higher cash liquidity improves the Company's financial flexibility.

Total liquidity including cash, financial investments, restricted cash and accounts receivable was BRL3.7 billion at June 30, 2019, already considering a debt repayment of BRL100 million in the quarter. We estimate that our total 2019 CapEx will be in the range of BRL700 million for operational CapEx primarily engine overhauls.

Lastly, we would like to share the continued success of GOL's liability management to net debt excluding perpetual bonds, the last 12 months EBITDA ratio was 3.1 times 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 dollar 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 BRL0.14. 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 2.8 times reflecting our commitment to reduced leverage in the Company's balance sheet.

Now, I would like to return to Kakinoff.

Paulo Sergio Kakinoff {BIO 5160310 <GO>}

Thanks, Rich. In summary, our results this quarter reflect the new competitive levels achieved by our company. Our commitment to continuous improvement in results has proven strategy of 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 client on new and modern aircraft that connect our main market 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 clients, while driving sustainable margins and returns for our shareholders.

And 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.

Questions And Answers

Operator

(Question And Answer)

Thank you. The floor is now open for questions. (Operator Instructions) Questions will be taken in the order they are received. We ask that when you post your question that you pick up your handset to provide Optimum sound quality. Please hold while we pull for questions. The first question will come from Michael Linenberg of Deutsche Bank.

Q - Michael Linenberg {BIO 1504009 <GO>}

Hey, good morning Kaki Good morning. Rich, I guess two questions, the first one as it relates to the Congonhas slots. I guess we did get a ruling out of an ANAC and their definition of I guess a new 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 can you talk about also presumably there will be in parallel some sort of legal appeal process, since I believe the bankruptcy court -- basically approved the divestiture the sell of those slots to you and both LATAM, so presumably that, that will be parallel and ultimately, there'll be some time frame when that ultimately is determined, can you just sort of talk about what's going on there ? Thank you.

A - Paulo Sergio Kakinoff {BIO 5160310 <GO>}

Hi Michael thank you for the question is, it's Kakioff here. Actually, you have no, yeah, information on any kind of legal request from any of the player so I cannot speculate on it. And I believe that those slots will be redistributed and implemented if you want to -- saw in a very short period of time. So I cannot tell that I believe but I would assume that since by October, latest in November, those airlines would be able to deploy their capacity to fulfill the redistributed slots and start up the operation. So that's my forecast for that subject.

Q - Michael Linenberg {BIO 1504009 <GO>}

Okay, great. That's helpful. And then just then just the second question, as it relates to distribution and your I guess the platform that you're on. I believe GOL has historically used the Navitaire system, and yet, as you become a bigger airline and you fly more internationally, there's an argument to be made to move on to maybe a more comprehensive system whether it's Sabre or Amadeus, what are your thoughts on that? You know are you at the point where maybe you have outgrown the Navitaire system and maybe considering an RFP to move on to say the Sabre system and Amadeus et cetera. Anything that you can provide us on that front would be great. Thanks.

A - Paulo Sergio Kakinoff {BIO 5160310 <GO>}

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

A - Unidentified Speaker

There's a big smile on his face.

A - Paulo Sergio Kakinoff {BIO 5160310 <GO>}

Actually we are, just things, I'd like to highlight, first of all we are basically about to conclude a RFP of the TSL system or the passenger. And we have our definitely have a back of the envelop -- the current, that I mean not there among the containers, among the candidates and technically speaking. We are pretty confident that the current supplier would be able to fulfill our technical requirements. I mean, the season itself has Navitaire is in new skys has developed itself in a way that they are more much more sophisticated than they were once the software was firstly conceived I mean, they are somehow catching up on the airline's needs.

And I just to tell you that they came to this RFP process, secondly speaking at the same level of competitiveness than the other containers. So, it they have been -- could -- will be decided on 2 dimensions, how capable those softwares or those systems will be able to fulfill our future requirements and we have hired and an external consultancy company, which is Fully equipped to drive us through this RFP process technically speaking and then help us to understand who, is going to be the best provider to our future needs considering our strategic plans.

And that can lead the lowest possible cost, you know how much we care about our cost structure and mainly about our cost advantage in comparison to the other peers, and that's the kink of our of our decisions, in because we are not going to compromise on in our cost structure. In all that whenever, you are talking on PFS assistance, you need to, to have the right balance between the cost and the revenue opportunities that in more sophisticated and complete system can provide to us.

So I think that's along the following weeks we will be able to communicate to the market, the result of such RFP and that's it. You're right. We are ready for more than, if I'm not wrong 15 months developing this process which is about to come to an end.

Q - Michael Linenberg {BIO 1504009 <GO>}

Okay, that's great. I think part of the Genesis from my perspective is that you have now become so big and to the point that you are 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. So 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'm glad to hear that. We're going to we're going to get some resolution on that front and it sounds like it's going to improve your costs. Or at least allow you to maintain low costs going forward. So thank you for that.

A - Richard Lark {BIO 3484643 <GO>}

Exactly right? Thank you very much.

Operator

The next question comes from Duane Pfennigwerth of Evercore.

Q - Duane Pfennigwerth {BIO 7329167 <GO>}

Hey, thank you. Just with respect to the revenue guidance for the remainder of the year. Obviously very, very strong in the first half. 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 sort of low single-digit growth exiting the year?

A - Richard Lark {BIO 3484643 <GO>}

Hi Duane. Good morning. We provided as you make a noted, we provided some, some little bit of look into how we're seeing the Q3 in terms of load factors and how that would play into both RASM as well as CASM. That number we provided there 11% to 13% that's what we're seeing. That's what we are seeing we just went through a industry consolidation which had a big effect on the second quarter and things are adding to stabilize now over the next couple of months where if you settle back came to a more normal situation, we're still seeing listening expansion and a couple of points.

Number one that I would say that if you want to go look at it glass half full that doesn't include the potential for the short end of the booking curve to increase. If demand hits at the back end of that the there's already in the third quarter of last year, it was a significant multi round fare increases, as you recall that we had the trucking strike in the second quarter, and which was mid May it really wasn't until the end of June that we were able to start to recompose. And we were recomposing from the end of June all the way until September, where they were literally around about 10 many rounds of of adjustments to get back to that and so with that, the comparison then for the third Q is, sorry the third quarter of last year is a harder one.

And then also in terms of sequentially in the second quarter at a very neutral supply scenario, where it is in the third quarter, we're seeing, there's going to be a higher increase in supply both with us as well as the competitive environment, maybe I'll ask Kakinoff to go onto couple of points there, but that's something that, we're keeping an eye on & it really hits kind of an individual level. Our specific capacity plan increases for the Q3 domestic market, which is obviously what drives, where your question is coming from -- are in the kind of the 3% level, although that's not the case for our competitors.

A - Paulo Sergio Kakinoff {BIO 5160310 <GO>}

Yeah, Duane. It's to be really straightforward here. We are pretty cautious when we are looking forward to just the revenue units. I think, we have now noticed some kind of not rationale behavior coming out one of our competitors and honestly, we can't understand that whether this is just a kind of noise in the future inventory seating available and we might be misreading that or if it's really enough rationale behavior coming as I said from one of our competitors. That made us be pretty cautious regarding our revenue outlook and, and also quite sensitive. I mean our behavior on this we will remain to be the same one that you have deployed already for almost seven years. We will be conscious of our role being the market leader and we will incentivize as much as we can the capacity discipline in the market. So, 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 fourth quarter of this year on.

A - Richard Lark {BIO 3484643 <GO>}

And maybe just if on the public available data, which obviously you have access to Duane, nobody else has access to. Right now within the system like I said for a whole, we are at about a 3% year-over-year capacity increase in the Q3. The overall industry is at around a 12% level. We don't have demand growing in that level. Which is a slide at the end of the Q&A. That's on the website. Where you can see how the current expectation for domestic market demand this year is almost -- on there is in a range of , 7% area.

And we've been . growing capacity below that to keep equilibrium stability and rationality. We've been a leader in that and so and then there is this one competitor in the group that has Q3 domestic capacity expansion plans in excess of 30%. And so we took -- look at that as well. And that's obviously reflected in our RASM expectations for the Q3 of this year. Because we're, portion of the market all three of us are competing head to head directly in the majority of the markets and net number sequentially is also not that much different. I mean sequentially if you go Q2 to Q3 of this year, it's around a 10% if you take what's in the system and the system of all the companies in Brazil domestic capacity it's around a 10% increase in domestic capacity sequentially. So that necessarily will have an impact on RASM, so there is no way to avoid that. But as Kaki said within that bucket. We are our number is in the low single digits. And so we're trying to contribute to the rationality and maintaining the equilibrium, but that doesn't just depend on us.

Q - Duane Pfennigwerth {BIO 7329167 <GO>}

Okay, that's helpful color 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 lack of MAX availability is holding you back to some degree this year, that 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 questions.

A - Richard Lark {BIO 3484643 <GO>}

That's good question, obviously as you mentioned the main driver 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 in stage length from the 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 second half into the first half of next year, without a doubt.

But we have initiatives across the supply chain, across the capital structure. And what I have always just mentioned 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's really a series of initiatives across the board, which represent for us and this is in addition to the MAX, potentially & this is I would say really more over the next 12 months. Not necessarily all in this year, but about BRL500 million of potential cost, of positive cost impacts. But across our entire company and we continue to work on that incessantly . He is independent of the fleet transformation process.

A - Paulo Sergio Kakinoff {BIO 5160310 <GO>}

And here, I would like also to highlight foe maybe of comparison, if you take 2019 as a basis and you for maybe to the economic results. That allows us to have a quite positive outlook regarding cost for 2020. Because you have basically none of the 77, that's a fact in reducing our costs happening this year. So you probably know that by right after the on grounding, we're going to be able to get in a few in two weeks something around to any, 277 MAX. And that would create a kind of cost reduction shock in some important goods, which would be quite considerable reduced level of cost in comparison to that one delivered or deployed by obviously in 2019.

So, we had previously considered that we would have that effect happening already in 2019 due to the grounding that was not possible. So it's pretty positive that we are delivering as confirmed by the guidance delivering the previously expected 2019 EBIT margin without getting any kind of benefit created by the 77 MAX and right after their own grounding which is expected to happen by the fourth quarter this year. We are going to have at least twenty aircraft being delivered to our company in a short period of time. So we are quite positive in that.

A - Richard Lark {BIO 3484643 <GO>}

In addition to that on the fleet side of the equation on the asset side of the equation. I mean you we provided some details this quarter on what we're doing specifically to deal with the MAX situation, which was basically the delays of the MAX and the replacement of those with that 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 set of those new operating leased air crafts that are coming into the fleet to bridge the gap here.

In addition to that, one of the things at we had assumed that the beginning of this year, which we ended up postponing because of the MAX situation was the further monetization of our owned aircraft, which we have been doing since 2016, we still have 11 NGs in the fleet, which we're keeping until the resolution of the MAX situation. But they represent for us, potentially BRL400 million of income once we get back on that.

That won't be happening this year, but we'll probably be back get back onto that of course next year. So it was kind of in a reorganization a lot of pressure on us to kind of keep our current costs. But we do expect some significant positive catch up next year coming out of the aircraft side of the equation as well. So we tried to give you some visibility into that and then 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 let's say lower than our current monthly lease rates on the additional operating lease NGs coming into the fleet. And that was a positive for us on the CASM side of the equation for this year and that will impact this year.

Q - Duane Pfennigwerth {BIO 7329167 <GO>}

Okay. Thank you very much.

A - Paulo Sergio Kakinoff {BIO 5160310 <GO>}

Thank you.

Operator

The next question will come from Dan Mackenzie of Buckingham Research.

Q - Daniel Mckenzie {BIO 15071178 <GO>}

Oh, hey, good morning. Thanks guys. Another question on cost here. Rich, GOL is getting some new investors here in the US that are not used to dealing with the foreign exchange movements. So I'm hoping to just talk a little bit about this, if we strip out the 9% depreciation in the Brazilian reais in the second quarter. So looking at the quarter on a constant currency or like-for-like basis versus a year ago. I wonder, if you can talk about what the CASK ex-fuel & EBIT, would have looked like. So core operating performance excluding the FX noise?

A - Richard Lark {BIO 3484643 <GO>}

Yeah, sure Dan. Thanks for the question. Good morning. Yeah on the CASK-ex the recurring CASK X fuel. Without the FX effect would have shown quarter, second quarter of this year, over second quarter of last year on a 9% increase versus the 12% increase that we reported with the FX effect. And then 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 and you just in terms of EBITDA the EBITDA would have been 29% without the FX effects versus the 26% that we reported.

Q - Daniel Mckenzie {BIO 15071178 <GO>}

Very good. Second question, here regarding the structural reorganization of SMILES and the move to discontinued talks and I wonder if you can elaborate a little bit on that. On the one hand Air Canada taught us that it can take a while on and it seems like it would be on the other hand it -- it seems like it'd be nice to get it done. But, then I guess there are, some crosswinds here, the longer you wait, I'm wondering if the cost to bring it in-house might fall just simply on a higher cost to redeem miles and so I'm just wondering, if you can just help us, reconcile some of the, the cross-currents here?

A - Richard Lark {BIO 3484643 <GO>}

Oh sure. Yeah as we announced the, the special committee that was created by the SMILES board in December last year. We went through a six-month process with that committee which was not successful in reaching a deal, and so we finalize that process. In the short term, when I say short term here in the next couple of months we are not doing anything specific on that we've been obviously extremely busy with what's been going on with fleet with the sector consolidation, with our growth with our international expansion, with our regional expansion and we have one team here at GOL, it's one kind of consolidated team and we will be very focused on the opportunities & the priorities we've been focusing on that you're seeing now.

Having said that I mean we, our intention is to complete a reorganization of the capital structure of our group to increase our sustainable growth rate, and for that and as well from to increase our competitivity long-term. And for that our intention remains to -- the fact that the take in of the minority interest of our loyalty program subsidiary. But the timing right now I don't have anything specific on that. When we initiated this in October last year. Our thinking was to have everything finalized in maximum over a two to three year period. So we're definitely within the window that we specified to do that because what we were focused on is really with that the long-term competitivity of the overall group in the context of Brazil, South America and globally.

As I think the other question highlighted I mean GOL today is a global airline in the sense that we are selling tickets all around the world that we have, close to a hundred inner lines and co-chairs. And so we're looking at the long-term growth rate of the group, the long-term sustainable growth rate, long-term competitivity. And so we're well within our are 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's where we are right now on that.

Q - Daniel Mckenzie {BIO 15071178 <GO>}

Understood and I guess I'm just wondering if I can squeeze one last one in here on , just macro. There's , a lot of moving pieces on the macro side, So leaving pension reform Congress has taken up tax reform and , I know it's early here, it's 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 is there and I'm just wondering if there's any sort of consensus view about the momentum of this potentially in the months ahead.

A - Paulo Sergio Kakinoff {BIO 5160310 <GO>}

Hi Dan, we have almost no information there. They are just speculation that we -- as we monitor. What we have seen is that the Brazilian States they are more and more sensitive to the damage caused by such high ex burden on the jet fuel the Brazilian ICMS and most of that has already implemented new state legislation of those are gradually reducing that taxation, but that's the almost single half material on this type of situation in Brazil at the moment.

A - Richard Lark {BIO 3484643 <GO>}

I think also referring to previous administrations is had always talked about sequentially once pension fund reform would be effected. The next mount to climb after that would be tax reform, which is a big part of the overall Brazil cost if you will. But right now the focus is on pension fund reform, which can alleviate significant amount of cash flow in the government over the next 10 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're doing on the tax side of the equation. Now, for example this project that we had in the state of Sao Paulo, which reduce the value added tax on jet fuel by half from 25% to 12%, that's been approved by the Sao Paulo State assembly, you saw the nine regional destinations that we're doing this year a part of that, that agreement, and that's significant and we've also done a good job. Not just in the state of Sao Paulo, but around Brazil with similar types of activities designed to have lower taxes on in terms of how we're managing our business scenario.

A - Paulo Sergio Kakinoff {BIO 5160310 <GO>}

That's what gives me the opportunity to also to highlight, one additional resource that you have just deployed, which is pretty common to you guys in the United States. The so called capacity purchase agreement. We have for the first time launch that, that kind of structure in the Brazilian South State of Rio Grande do Sul that allowed us to add six new destinations to our domestic network and we are also supposed to announce new agreements like this in other some point another 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. So this is a very promising way to further develop not only our Network, but the Brazilian airline industry, because we are bang offering to the customers access to the -- aviation industry, while before they were completely out of that system just because they couldn't get access to the main routes due to the infrastructure constraint. So that would help us also to further reduce on average, the tax burden coming Itau specifically the ICMS tax

A - Richard Lark {BIO 3484643 <GO>}

And as you know, well, Dan, the GOL level on the corporate tax side of the equation. We have over BRL4 billion of off-balance sheet net operating loss carry-forwards, tax credits if you will. And so as we go back to being profitable. We have a significant tax assets that we're not using right now that tax. That tax asset, as we utilize it which could potentially be over the next five years or so represents about BRL1 billion of potential net usage if you will. 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 the our corporate taxes.

Q - Daniel Mckenzie {BIO 15071178 <GO>}

That's perfect. Thanks for the comprehensive answers you guys.

Operator

The next question will come from Syth Savanthi of Raymond James.

Q - Analyst

Hey good afternoon everyone, this is Matt on for Savi. Richard appreciate the additional color you gave in terms of the MAX and some of your expectations there just a minute ago. But I was wondering could you maybe talk about your thinking in terms of the day that the return date even though we don't know when that is maybe think about thinking about it in two parts. May be firstly in terms of your, your in-house fleet, how quickly can you get those brought back up whether it's in terms of maintenance or training then, how long of a lag would you want 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 are going to induct maybe per week or per month that you can handle based on the current production schedule?

FINAL

Bloomberg Transcript

A - Richard Lark {BIO 3484643 <GO>}

Yeah, that, that is that's obviously an issue that you have a large ecosystem. That's, that's dealing with that there, I mean we're in the top five operators of MAXes in the world, you got Southwest American United. And each one of us got different ways of dealing with it. But in our planning as we mentioned. We covered all of our needs, through the high season at the end of this year, which would be, pretty much through February of next year. We've covered those in terms of identified aircraft that we've already leased or we would lease or sublease & so we're covered.

So we have a lot of flexibility to deal with whatever comes out of Boeing in terms of when they actually get the on un grounding as well as the aircraft -- of the coming out of the factory as well as those that are in storage. So we have flexibility to come at it in a bunch of different ways. But we expect that there would be no one to two months process once the un grounding happens for aircraft to -- our aircraft to be accessed.

And operating in the fleet and that's, I'm referring specifically to the aircraft that are in the future delivery schedule of the future production schedule Boeing. The seven aircraft that we have currently grounded, it would be pretty much immediate access, because our pilots already trained on that and we have 100% fungibility on that. And we also have the ability through these deals we've 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 aware which we could then shift around.

And I think your other question in terms of the on the operating side and in terms of pilots, mechanics and our capacity there, I would just say the same thing, We think, there kind of be like a one to two months process, where we'd have to work out there's a major 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 and I think, we will be highly speculative at this point on exactly how that's going to work. But there are, there is a lot of planning already on that in terms of how it would work, when the un grounding happens.

A - Paulo Sergio Kakinoff {BIO 5160310 <GO>}

Hey Matt, actually since the grounding every single decision regarding our fleet capacity that we have taken is considering doing that in any scenario. We would put pressure on our pilots mechanics and therefore after making possible to sublease Seven aircraft, to the Brazilian high season, those other five that we have already added to our fleet this year. We gave ourselves the opportunity to decide how gradual we intend to reintroduce those planes into our fleet, without put us any kind of additional pressure which would be pretty much un desired.

GOL was the first airline in the Western World to ground the planes less than 24 hours after the accident. We took the decision at the time exactly to show to our customers Pilots, employees that we would compromise on neither on safety or 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 you just highlight our assets being perceived by the customer like a safety first company. And therefore, once capacity need is addressed by all those alternatives that we have already built in, there is no reason to rush on that.

A - Richard Lark {BIO 3484643 <GO>}

If you had given, 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 MAXes for this year and next year. And that's already organized, that's already locked in, if you want to do it if you will, which is basically, another 10 NGs in the second half of this year. And then, next year basically we would then be receiving 25 MAXes during the course of next year and next year to finish this year effectively with 7 MAXes and finish next year with 32 MAXes and finishing this year with a 106 NGs and finishing next year with 800 NGs is what I'm saying. And then we will be keeping the 700s at around this 24 level to keep our focus on our regional expansion where we're effectively using there -- those aircraft to compete in those smaller markets. And that data, that's basically our plan in terms of the numbers. How we get there could have a variety of alternatives depending on this linear programming exercise. It's going to have to be done within the Boeing ecosystem and all the other clients that they have there to deal with once the ungrounding happens.

Q - Analyst

That's great, thank you for all that additional color as well as that chart you referenced in the slide deck, really appreciate all that. And as a follow-up, if I can just quickly touch on, when you spoke of the 700s those regional markets just a quick one in terms of those regional markets I know most of them are launching, both 3Q and 4Q and then 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 before load factors or how demand is filling up in those markets. Thanks for taking the question.

A - Paulo Sergio Kakinoff {BIO 5160310 <GO>}

Okay, good. Let me highlight the two different dimensions, and they are, I mean complementing each other of our regional strategy. First and most important one is that our domestic network expansion introduced by our own fleet. I mean, new destinations to be operated with the 737. And we have just announced its six new ones for this year only, there are more to come on the next year on and that works in combination with the regional, state regional strategy through the CPA agreements that I had just mentioned that we have in the 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 the South State. So in both directions along the following two years, we are supposed to announce new destinations, new regional destinations and two net strategy to further enhance our network destination and consequently load factors because the sum of those new regional flight all of them connecting to our main hubs and then we will have even more powerful connecting structure than we do have today.

Q - Analyst

Great, Okay. Thank you.

A - Paulo Sergio Kakinoff {BIO 5160310 <GO>}

Did I answer to your questions or you would you like to know personally of the...

Q - Analyst

Yes. No. It's certainly good color, Just in term of, if you have any early sales on the books, I guess, I know they haven't really started yet but maybe how that is looking if it's in line with expectations or still a ways to go there ?

A - Paulo Sergio Kakinoff {BIO 5160310 <GO>}

Okay, actually the sales partner is felloeing exactly the current market dynamics, nothing another higher or below the average partner in every route that whenever we are starting a new flight, there is a ramp up curve and is exactly that what's going on with all of those destinations being recently announced by the company.

Q - Analyst

Perfect. Thanks Kaki.

A - Paulo Sergio Kakinoff {BIO 5160310 <GO>}

Thank you.

Operator

Our next question will come from Josh Milberg of Morgan Stanley.

Q - Josh Milberg {BIO 19336060 <GO>}

Good afternoon, Kaki, Rich. 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 and I think that this is clear, but my first one is if you could just confirm that you treated the BRL192 million provision for aircraft returns as a non-recurring expense and additionally tell us what the exact impact of the credits from contractual lease term reductions were. And then actually just adding to that, I also wanted to ask what if any other adjustments you made to get to that adjusted EBIT, EBIT number and also whether you recognize losses related to the funding provided to Avianca Brazil and Elliott. Those are my main doubts.

A - Richard Lark {BIO 3484643 <GO>}

Sure Joshua, the BRL192 million for the provision was related to four aircraft as a result of this fleet reorganization that we did because of the MAX situation. That's why that event happened, and so yes that is in the non-recurring bucket there in the quarter and that also gets matched with a number of about a BRL133 million, which effectively is that is a debt reduction. But if you will, on those contracts and those contracts are going out earlier that generates a reduction in debt in terms of the IFRS16 finance lease calculation related to those aircraft return.

So, both of those numbers, the BRL192 million provision for aircraft return as-well-as the BRL133 million number which is in the other expense line there related to the cancellation of those leasing contracts. Those are the main items, there's some other tax effects in there. But those are the main items that are in that BRL80 million net adjustment that we back out for you guys there in terms of understanding the quarter-over-quarter cost adjustments. What's not in that number is we wrote off in the quarter around BRL22 million related to our 45,000 passengers that we transported for Ocean Air up until the end of June, to help out with the disruption of that company, were the company that most transported passengers there to help out that situation.

So there was about BRL22 million rise in the quarter, Q2 that was written off or provisioned, if you will on that, that's the only amount that has been dealt with at this point related to any exposure that's operational exposure that we have there. We're not going to recover that, from that situation there, the other credits that are there are still there, which is the DIP financing as well as the participation in the credit that's pending the outcome. We have to wait for the outcome ultimately of what happens there in the legal re-structuring process of that company.

The next milestone is at the end of August where we would be making a decision or not, but we're following the rules there, the appropriate rules there. We going back to the BRL22 million that we treat as operational you could decide if you want to treat that as a recurring and non-recurring or not. That's not in the BRL80 million at BRL22 million is not in the BRL80 million also I should say that the way that's treated in the accounting that is a reduction to revenues. It's not an expense item, it's in the recurring revenues and so there's a BRL22 million reduction in revenues in the Q2 related to those -- that air traffic liability that we helped out with on the Ocean Air situation.

Q - Josh Milberg {BIO 19336060 <GO>}

Okay, Richard that was a very helpful and clear response, one more related clarification just on your full year '19 EBIT margin guidance that, how are you, are you considering that the big first, that the big second quarter provision for the aircraft returns in those numbers or not?

A - Richard Lark {BIO 3484643 <GO>}

Well, yeah, I mean all of our numbers are fully loaded in terms of what we expect. When we talk about -- what we're thinking about full year and I think, I don't know, I think we'd 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. If anything is excluded, we will footnote it there to show you about how we're thinking. And so that is, that's fully loaded for what we expect for the year. Now the comings and goings as a relates to the aircraft portfolio, that includes what we expect in terms of returns of aircraft as well as sales of aircraft and that's also adjusted for this suite reorganization that we've done over the last couple of months to deal with the MAX situation. That's all reflected in those projections.

Q - Josh Milberg {BIO 19336060 <GO>}

Okay. Got it. Thank you very much.

Operator

The next question will come from Rogerio Araujo of UBS.

Q - Rogerio Araujo {BIO 17308156 <GO>}

Yeah, hi Kak, hi Richard. Congratulations on the sterner results. I have a couple of questions first is so there was a distribution of Avianca Brazil lastly in June, expect for Cogonhas Airport, which was distributed yesterday. So, my question is if you could provide a comparison of tickets fares, sold in July versus those sold in June and May, so did this capacity expansion translated into huge normalization or partial normalization or not. This is the first question. Thank you.

A - Paulo Sergio Kakinoff {BIO 5160310 <GO>}

Hi Araujo, actually that is not, a that will be a fair comparison because July is the high season and the capacity is short caused by the Avianca Brazil, operation termination made the fares to achieve -- they are fixed considering the way that we have managed the revenue management structure and the regular rules. I mean, that when suddenly Avianca stops it's operation they were taking out of the market 50 planes that was not replaced by none of the competitors, because until the end of July because there was not a time enough to do so.

Once July was very if you will route 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 I can tell that considering the current outlook. By October, we are going to have basically all the capacity previously deployed by Avianca being replaced by the three current incumbent. That was more a kind of short effect between August and September and then from October on a new equilibrium between capacity & demand will be in place and that equilibrium is pretty much comparable to that one that the market saw in October last year. So that it was more a kind of short phenomenon happening pretty much concentrated in August and September was in July, the high season does not allow us to have any kind of produce any kind of fair comparison between the two mentioned months June and July.

Q - Rogerio Araujo {BIO 17308156 <GO>}

Very clear. Thank you. So my second question is a follow-up on Josh questions on the credit, That was recognized for BRL133 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.

A - Richard Lark {BIO 3484643 <GO>}

We have four aircraft that are being returned and that different than original plan. And so the way that works is that when those aircraft when you make a decision you have a specific date where you're going to be a returning your aircraft, in those case, it's 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 and it's very expensive to return aircraft after the complete engine overhaul. This is obviously future cash that would be spent as well as the adjustments you make on the assets and liabilities on the balance sheet. So in this particular case that credit that is realized that BRL130 million is basically the excess of the assets over the liability, you do a net effect & then you run that through the income statement.

Q - Rogerio Araujo {BIO 17308156 <GO>}

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

A - Paulo Sergio Kakinoff {BIO 5160310 <GO>}

Thank you.

Operator

(Operator Instructions) The next question will come from Roberto Versiani of Citibank.

Q - Analyst

Hi, guys, thinks. He is Roberta. I'm from Stephen Trent. I have a question regarding Avianca Brazil slots. Even though no foreign risk bid on ongoing, do you see potential for -- foreign interest in domestic operations in any other Brazilian airport. And also, is that correct to assume that GOL had the highest amount of route overlap with Avianca Brazil versus the other domestic airlines. Thanks

A - Richard Lark {BIO 3484643 <GO>}

Roberta second part of the question was understood. Yes. We had the highest overlap ratio with Avianca in comparison to the other peers, but I didn't understand your first part of your question please could you repeat ?

Q - Analyst

Yes, sorry. I wanted to know if you see any potential -- foreign interest in other domestic operations in Brazil, in other Brazilian airport?

A - Richard Lark {BIO 3484643 <GO>}

Maybe if you could speak a little bit slower because it kind of muffle the question.

A - Paulo Sergio Kakinoff {BIO 5160310 <GO>}

Yes, if you could speak little beat a slower. If you see any kind of opportunity for what?

Q - Analyst

For foreign investors foreign interest in domestic operations.

A - Paulo Sergio Kakinoff {BIO 5160310 <GO>}

Oh, I'm sorry yeah, yeah, we do sorry that possibly he is over loudspeaker here because it was not so clear. yeah. We do see there's opportunity, there are some airports where several interesting slots are available and they could be fulfilled by a new permit, and those are airports with facility -- potential mainly for a low cost, low fare company to get in.

Q - Analyst

I'm sorry, but like which ones could you give us more detail?

A - Paulo Sergio Kakinoff {BIO 5160310 <GO>}

I said clearly you have Cancun as one of that airport.

A - Richard Lark {BIO 3484643 <GO>}

Any airport where you don't have slot restrictions, anybody can go in. I mean you have the top six airports in Brazil are pretty concentrated. So we know that includes, , Congonhas, Guarulhos, Santos Dumont, Brasilia, Salvador I mean those are very concentrated and there's really no additional capacity there for like, a lot of these other let's say more regional or we don't have secondary airports in Brazil. Each city generally has an airport of some we have over 60 operational airports commercially in Brazil of the of the over 2,000 air facilities, we have in Brazil, you know we have about 60 to 70 that are operated today heavily for commercial aviation. You know outside of the top ten there's capacity, if you will landing rights where anybody can go into those & then that's a function of demand as well. Brazil is very concentrated, where in these top six airport you have more than 60% of passenger traffic going in those airports & so it's just so concentrated.

Q - Analyst

Okay. Thanks. Thanks very much

Operator

(Operator Instructions) The next question will come from at Petr Grishchenko of Barclays?

Q - Petr Grishchenko {BIO 19084897 <GO>}

Hi, good afternoon, and thanks for taking my questions. So I joined the call later. Sorry I don't know, if there was already answered. But can you provide a more color on kind of your debt amortizations for 2020 and any thoughts on the financing options, local market bond, you did obviously to convert this year. So any thoughts on the liability amount will be helpful.

A - Richard Lark {BIO 3484643 <GO>}

Sure, Petr. Yeah, I mean we as you know we've been very clear in our plans there next year. Our plans are to pay the $300 million term loan as well as the remaining amount on the 2022 bonds. Those bonds are callable at attractive levels in February of next year. So sometimes between February and August we would be affecting those amortization, which is significant. Now in addition to that we are also as you know, we transformed the Brazilian real debentures last year into a three year amortization schedule. When we started that we had one point BRL1.1 million that was transformed into a three-year semester we pay out. Which is now the remaining outstanding on that is BRL750 million, which basically be fully amortized over the next two years.

The convertible bond that we issued in two phases where we saw recently we did another $96 million gross, the total amount on that raised for us is around $425 million. That is the cash that's now reserved to do these roughly $400 million of amortizations, in the second and third quarters of next year, as it relates to the term loan and the 2022 bonds. And I guess, the only other point, I would make on that is that given your question is we have zero additional plans about raising any type of financing of any type of unsecured financing that or equity in the capital markets. All of our efforts now are focused on secured financing vis-a-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 a 130 aircraft about 60% of that would be done through ownership. Financing mechanisms where we would be building equity on those aircraft like we did in our first order we did 40 aircraft, in this second order we will do somewhere between 70 to 80 aircraft through finance lease mechanisms.

Just a final comment on, you mentioned the convert. I mean, the convert today is actually it's in the money so even though that is in the maturity schedule in 2024 because we have the net share settlement mechanism, where you can pay either in cash or stock if the convert is in the money at maturity. Having said that, the convert is already in the money. And so, we view that as equity on the balance sheet, meaning that is a 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 $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 US dollar maturities until 2025. I think it's important to highlight that. Because the end game on all this liability management we've been doing the last couple of years. It's basically to get back to that situation. And that will be matched against that took $650 million, will be matched against the equity build-up. The off-balance-sheet equity build-up on the aircraft, which by 2025 will be about $700 million. So that's why we would like to say we're perfectly matched in terms of currencies in asset & liabilities, even though those aircraft liabilities those aircraft assets which are Dollarized traded in dollars and create significant equity value for GOL you can't 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, and that's we're basically back on track for that, so that's basically how I would answer your question.

Q - Petr Grishchenko {BIO 19084897 <GO>}

Great. Thanks a lot for all the details Richard and best of luck to you guys.

A - Richard Lark {BIO 3484643 <GO>}

You're okay. Thank you Petr.

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.

A - Paulo Sergio Kakinoff {BIO 5160310 <GO>}

Ladies and gentlemen. I hope you found our presentation & the Q&A session helpful and our investor relations team as always is available to speak with you as needed. So 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.