Q2 2006 Earnings Call

Company Participants

- Richard Lark, CFO

Other Participants

- David Strine, Analyst
- Fabio Zagatti, Analyst
- Gonzalo Mendez, Analyst
- James Parker, Analyst
- Jamie Baker, Analyst
- Jander Medeiros, Analyst
- Marcello Luna, Analyst
- Michael Linenberg, Analyst
- Ray Neidl, Analyst
- Rodrigo Gomez, Analyst
- Travis Anderson, Analyst
- Victor Fellis, Analyst

Presentation

Operator

Good afternoon, ladies and gentlemen. At this time we would like to welcome everyone to the GOL Airlines Second Quarter 2006 results conference call. Today with us we have Mr. Richard Lark, Executive Vice President Finance and Chief Financial Officer. (Operator Instructions)

Today's live webcast, including both audio and slideshow, may be accessed through GOL's website at www.gol.br/ir. The slideshow presented by management today is available on the website in the Investor Relations section.

Before proceeding let me mention that forward-looking statements will be made under the safe harbor of the Securities Litigation Reform Act of 1996. Forward-looking statements are based on the beliefs and assumptions of GOL management on information currently available to the Company. They involve risks, uncertainties and assumptions because they relate to future advance and therefore depend on circumstances that may or may not occur in the future. Investors should understand that general economic conditions, industry conditions. And other operating factors could also affect the future results of GOL and could cause results to differ materially from those expressed in such forward-looking statements.

Now I will turn the conference over to Mr. Richard Lark who will begin the presentation. Mr. Lark, you may begin your conference.

Richard Lark {BIO 3484643 <GO>}

Good morning. First of all I would like to welcome you to GOL's Second Quarter of 2006 results conference call. Junior is not with us today, as last night at 9 PM he became a father for the third time with the birth of his third daughter. Dad, Mom and the new baby are doing just fine.

In this quarter if we start the presentation on slide number 2, we reaffirmed our virtuous cycle, which creates the necessary conditions for the popularization of air travel in Brazil and South America.

Moving to slide 3, entitled Highlights, the Second Quarter 2006 represented another quarter of profitable growth for GOL. Our net income in the First Quarter was R$106.7 million in U.S. GAAP. GOL maintained its high margins, as indicated by our 19% pretax income margin, sustained by our constant focus on low cost, high productivity and intelligent yield management.

Our position as the lowest cost provider in the Brazilian air transportation market and as the global leader in profitability remains unchanged. GOL remains committed to providing high-quality passenger transportation services and driving fares lower to create further demand and stimulate demand, what we call the GOL effect.

In the Second Quarter of 2006 the addition of new aircraft to the fleet permitted a 50% expansion in capacity and the addition of 62 new daily flight frequencies. Our capacity and 3.3percentage point increase in load factor to 75.9% contributed to a 57.3% year-over-year growth in our RPKs, resulting in a higher domestic market share, which reached approximately 35% at the end of 2006 Second Quarter. We are focused on continuing to reduce our costs so we can lower our fares further and continuing to increase demand for our services.

Slide number 4 in the webcast presentation shows the recent additions to our fleet and base network. We added five 737s in the Second Quarter. And ended the quarter with a fleet of 50 aircraft. We plan to finish the Third Quarter with 56 737 aircraft in the fleet. We plan to expand our network with new markets in Brazil and South America and additional flights frequencies supported by our fleet expansion of new Boeing 737-800-NGs.

During the Second Quarter we added one new market, bringing our total number of airports served to 50, which is ahead of plan.

Please move to slide number 5 in the webcast presentation. On this slide you can observe our capacity and network expansion in a more detailed manner. During the quarter GOL operated an average of 48 aircraft, which was an increase of 50% over the Second Quarter of 2005. And 11.6% over the First Quarter of 2006. When compared to the same quarter of the previous year our capacity expanded to 50.4% in terms at ASK volume of 4.6 billion. And RPKs increased 57.3% to 3.5 billion.

When compared to the First Quarter of '06 ASKs increased 6.9% and RPKs were 14.9% higher. Such capacity expansion permitted GOL to reach 500 flights per day at the end of the June quarter.

Moving on to slide number 6, our net revenues in the Second Quarter of '06 grew by 50.1% to R$844 million when compared to the same period in the previous year. Higher capacity, in conjunction with higher productivity, played an important role in the Second Quarter revenue growth. Increased productivity from GOL as a result of higher aircraft utilization at 13.9 block hours per day during the quarter. And a higher average stage length which increased 14.7% year-over-year.

The ability to provide low fares has been a key factor to overall revenue growth. As the lowest cost provider of passenger air transportation in South America, GOL stimulates demand with low fares. And has increased the number of passengers traveling by air.

A 9.6% increase in average fares, combined with a 14.7% increase in average stage length, resulted in a yield decline of 4.7% versus the Second Quarter of 2005 to R$0.223. Lower yields resulted in revenues per available seat parameter, or more RASK, of R$0.182 remaining flat versus the Second Quarter of '05.

Compared to the First Quarter of '06, yields decreased 17.5% and RASK decreased 8.5%. The weaker than expected yield environment in the quarter was also influenced by competitive factors, which have affected the entire industry in the short term.

On slide number 7 we will observe that what yields did decrease 4.7% in the year-over-year comparison, we reduced total CASK by approximately 1%, which combined with the 50.4% ASK expansion, resulted in a 42.3% growth in EBITDAR, amounting to 221.6 million. EBITDAR is an indicator of operating results before accounting for aircraft ownership expenses such as aircraft rent.

Total CASK at R$0.153 decreased R$0.0014 due to strict fuel management practices, increased scale and productivity. And increased average stage length, lower sales and marketing expenses, lower aircraft rent. And the 11.7% appreciation of the Brazilian real against the U.S. dollar, partially by increases in scheduled maintenance expenses.

Jet fuel expenses decreased 1.9% over the previous years quarter per ASK, despite an 11% increase in the jet fuel price per liter, due to improved fuel consumption and increased stage length and the results of our hedges.

It is worth highlighting that in a year-over-year comparison the 11.7% appreciation of the Brazilian currency offset a large portion of the increase in the international price for crude oil, driven by a 33% increase in the price of WTI and a 30% increase in Gulf Coast jet fuel prices. Meaning that GOL has been last impacted than its low-cost peers by the increase in international fuel prices.

GOL's nonfuel CASK at R$0.092 showed a slight reduction during the quarter, decreasing 0.2%. The strength of the Brazilian real has not only kept our jet fuel increases lower than our low-cost peers. But has also helped us reduce our other U.S. dollar-denominated expenses, as well as U.S. dollar-denominated disbursements such as advances for aircraft acquisition.

On the next slide, slide number 8, we show our net financial results. Financial income in the quarter increased R$11.1 million to 53.1 million, principally due to financial gains related to fuel hedge results reported as financial income. And higher investment income on cash balances. Our financial expenses increased R$7.7 million to R$24.5 million due to a planned increase in long-term debt. Our net financial results for the quarter were R$28.6 million.

On the next slide, slide number 9, we show a comparison of the effects of net income between the two quarters. In the Second Quarter of 2006 net income was a record $R106.7 million, representing 12.6% net income margin. And a 45.4% growth over the Second Quarter of 2005.

Running down the main differences, as already highlighted, net revenues increased $R281.8 million. Jet fuel costs increased by $R91.2 million, due to 54.8 million more liters consumed and 11% higher jet fuel prices, or reduced 1.9% per ASK due to improved fuel consumption and hedging.

Commercial expenses increased by 25 million overall related to higher sales volumes. But decreased by 12.5% per ASK due to reductions in commissions and an increase in ticket sales on GOL's website, which reached 82% during the quarter. And this was partially offset by increases in institutional marketing activities.

Labor expenses increased $R33.7 million overall and 6% per ASK due to a 6% cost of living increase on salaries. The number of employees increased 80.6% related to planned capacity expansion.

Other operating expenses increased by a total of $R84.8 million, principally due to an increase in maintenance expenses of 114.7% per ASK. And a 35.9% per ASK increase in aircraft and traffic servicing, offset principally by a 21.8% reduction in aircraft rent per ASK and a 5.7% reduction in other operating expenses per ASK.

Main expenses were scheduled maintenance of five aircraft engines, use of spare parts inventory. And repair of (inaudible) materials. As mentioned, net financial results increased $R3.5 million in the quarter.

These were the main impacts on net income. A more comprehensive breakdown and explanation of our expenses can be found in our earnings release that you have already received and that you may access on our website at www.voegol.com.br/ir.

In the Second Quarter of 2006 earnings were R$0.54 per share or US$0.25 per ADS. And represented a 42.1% growth in EPS and a 56.3% growth in earnings per ADS over the Second Quarter of 2005.

A net quarterly dividend payment of $R27.2 million, representing approximately R$0.14 per PN or US$0.064 per ADR was approved at the June 16 Board meeting for payment on August 15, 2006 to shareholders of record on June 20, 2006.

On slide number 10 we show our cash flow for the Second Quarter of 2006. At the end of the Second Quarter our cash balance was approximately $R1.3 billion. During the quarter our cash balances increased $R342.5 million.

Operating cash flow was positive at 2.1 million, mainly due to increased earnings for operations, offset by a decrease in accounts payable, a net increase in deposits for aircraft maintenance. And a decrease in other liabilities. GOL currently has US$195 million on deposit with lessors for future aircraft maintenance.

Investing activities used $R152.1 million of cash consisting primarily of $R98.9 million of advances for aircraft acquisition and $R49.9 million of acquisition of property and equipment. GOL currently has US$240 million in predelivery deposits with Boeing for future aircraft acquisitions.

Cash provided by financing activities during the quarter was $R492.5 million, consisting primarily of $R565.9 million increase in long-term financing, partially offset by $R73.6 million in dividends paid.

Moving to slide No. 11. GOL's strengthen its capitalization in the quarter with the closing of three long-term debt financings. On April 5, 2006 GOL completed a debt Capital Markets issuance of 200 million 8.75% perpetual notes with no fixed maturity. And callable by GOL after five years. The issue was assigned a credit rating of Ba2 by Moody's and BB by Finch. Proceeds will be used to finance fleet expansion.

In June 2006 GOL closed a $R75.7 million six-year loan with the BNDES, the Brazilian National Economic and Social Development Bank, with an interest rate of 2.65% over the long-term borrowing rate. Proceeds will be used primarily to finance the construction of the GOL Aircraft Maintenance Center and other IT investments.

Also in June '06, GOL entered into a US$50 million 7-year loan with the IFC, the private sector arm of the World Bank Group, at a rate of 1.875% over LIBOR. Proceeds will be used to finance spare parts inventory and working capital. The proceeds from the BNDES and IFC financings will be funded in July. Our cash balances, plus interest income and retained earnings, will be the primary funding sources for future aircraft acquisition.

On slide number 12 we show the relative performance of GOL in the U.S. and Brazilian stock markets. In 2006 through July 18 our ADS's have outperformed the American Stock Exchange Airline Index by 11.7%. And outperformed the Tier 1 LCCs by 39.9%.

Our PN shares have underperformed the Bovespa Index by 6.9% in the same period. Our average daily trading volume in 2006 has been approximately US$29 million a day on the NYSE and $R9 million a day on the Bovespa. GOL is one of the most liquid airline stock and one of the most liquid Brazilian stocks being part since May of 2006 of the IDR X50 Index under Bovespa.

On slide number 13 we show that our industry leading growth and profit margins continue to be a benchmark for the global airline industry. Our PE multiple is a significant discount to the other leading low-cost airlines, despite our superior earnings growth rate and profit margins, which are among the highest in the industry worldwide.

Transitioning to slide number 14 we show our current fleet plan for the next six years. The addition of 12 more Boeing 737 aircraft to our fleet in 2006 will allow approximately 45% expansion in seat capacity for the full year. By the end of 2006 we expect to have 62 fully operational 737 aircraft. By the end of 2012 we plan to have a fleet of 96 aircraft, primarily 737-800s, representing a 10.4% compound growth rate in seats over the next year -- six years.

The incorporation of new 737-800s into the fleet is projected to produce substantial cost savings. The reduction in the average age of GOL's fleet from 7.3 years in 2006 to 4.8 years by the end of 2007 will contribute to lower our maintenance expenses.

On side number 15 we have some images of GOL's new 737-800-NG aircraft, which are shown here in tests. And which will start to join our fleet next week. The new larger aircraft have short field landing capabilities, which will permit landings of this larger aircraft in airports with shorter runways, braid such as the Santos-Dumont Airport in Rio, which is one of the busiest airports in Brazil.

As GOL transitions to newer aircraft with a 25% larger seat capacity, fuel economizing wing (wipes) and lower financial costs, we expect to reduce CASK by approximately 4.4%. These cost savings will allow us to continue to drive fares down and further stimulate demand.

On slide number 16 we have some recent pictures of GOL's new Aircraft Maintenance Center at the Confins Airport, in the state of Minas Gerais, which is equipped with the state-of-the-art technology in aircraft maintenance. When fully operational next month, we expect to be able to achieve significant reductions in our maintenance costs and an increase in our aircraft utilization.

On slide number 17, we can see GOL's next international destination, Santiago de Chile. With a population of 5 million inhabitants, Santiago concentrates nearly one-third of Chile's entire population. And is the most important city in the country. And one of the most important financial centers in South America. We expect to begin operations in Santiago in mid-August with daily flights between Sao Paulo and Santiago and Buenos Aires and Santiago. The Buenos Aires/Santiago route is the second most traveled inshore continental city pair in South America after the Sao Paulo Buenos Aires city pair.

On slide number 18 we review our guidance, one of the key elements of GOL's disclosure process. GOL's integrated approach to corporate disclosure contains three major elements, required financial reports, supplementary disclosures. And interactions with investors and intermediaries.

In the Third Quarter of 2006 the scheduled addition of six new aircraft to our fleet will allow a 45% increase in available seat capacity over the same period of 2005. For the Third Quarter we expect a load factor in the range of 75 to 77%, with yields in the range of R$0.26 to R$0.28. We expect a stable foreign exchange rate environment in the near-term, supported by good economic fundamentals in the Brazilian economy. We expect higher oil prices will continue to impact our fuel costs. For the Third Quarter of 2006 we expect a nonfuel CASK in the range of R$0.09 to R$0.10.

Our guidance for 2006 is based on GOL's planned capacity expansion and the strong demand for air transportation in Brazil, driven by strong Brazilian economic fundamentals and demand stimulating low fares. We expect full year load factors to be higher-than-expected in the range of approximately 75%. Projections are for 2006 full year EPS in the range of R$3.9 to R$4.3 per share, representing annual EPS growth of over 50%.

For 2007, we expect to add at least 13 aircraft to the fleet. And expand capacity by at least 30% to adequately serve demand and add new markets. We plan to continue to popularize air travel in South America through our expansion, technological innovation, improved operating efficiencies, strict cost management and the lowest prices.

I will finish the presentation with slide number 19, where we highlight our competitive strengths, which are essential to keep our successful business model and the virtuous cycle. We count on our highly productive workforce and prudent management to always deliver quality customer service with low fares at the lowest cost in the market to keep our strong brand and high profitability.

Having now concluded this brief presentation we would like to thank you for your attention and turn the floor over for Q&A, during which we will be happy to respond to any questions may have.

Questions And Answers

Operator

(Operator Instructions) James Parker of Raymond James.

Q - James Parker {BIO 1506864 <GO>}

Just a couple of questions. One, regarding your Mexican joint venture that has been proposed. It appears there are a total of seven startups that are operating now. And we haven't heard much from GOL on this. Do you still have plans to do the Mexican venture? And if so, what are the status -- what is the status of your Mexican operation?

A - Richard Lark {BIO 3484643 <GO>}

We don't yet have the concession approved to operate in the -- with the recent elections in Mexico, both prior to and immediately after the elections, those things are more difficult, or not legally possible. We still do have plans of going forward with our joint venture with our Mexican partners.

Having said that we also think that there is an advantage to getting a glimpse of both value proposition, as well as cost structure of these other startups that you mentioned that have recently started up really over the past seven months or so in the Mexican market. We think there will be advantage to see that.

Once we had a concession authorization there would then be a process of three to four months after that to get the appropriate technical approvals, airline operating certificates and so on. But currently we don't have any news on that first part, which is the concession approvals. So it is difficult to say exactly when we would start flights in the Mexican market. But certainly at this point would not be in 2006, it could possibly be at the beginning of 2007.

Q - James Parker {BIO 1506864 <GO>}

Second question has to do with the Varig. What is the current status? We know the current status of VERIG. But what will be the impact of the Volo Group investing in VERIG? What will be the impact on GOL in terms of are there any airport slots that you all will get? Are there VERIG aircraft that you think you may get? What is the impact of this VERIG development on GOL?

A - Richard Lark {BIO 3484643 <GO>}

First I would say that there's not clarity on the situation in terms of what is exactly happening there, nor do we have any knowledge of what their plans are there or for that company.

In terms of our own plans, out both slots, routes and aircraft, continuing to be independent of that situation we have our fleet expansion plan this year, which does require leasing of new aircraft from lessors. And we have those needs arranged. And we also know where we want to group in terms of routes and slots and areas. And the process of awarding of routes and slots is taking place on a regular basis, as we speak.

Obviously VERIG has been canceling flights and reducing capacities, which has put a lot of pressure on the overall system in the short term. But we expect to grow both in terms of leasing aircraft. This year we also have -- we have 11 aircraft arriving from our purchase order with Boeing. And as well to obtain approvals to operate routes and slots in the markets we want to operate, not just in Brazil. But also in international markets that we're expanding.

Obviously, they are related in the sense that the continual downsizing of VERIG puts a lot of pressure on the demand side of the equation due to reduction of their supply. And could potentially present opportunities to grow faster in the short term. But again we don't have any specific knowledge of what their plans are in the short term.

Operator

Michael Linenberg with Merrill Lynch.

Q - Michael Linenberg {BIO 1504009 <GO>}

Just to follow-up on VERIG, I know you commented and said that your plans are independent of what they do. Now that they are proceeding to just operate the Rio, Sao Paulo shuttle over the next week. And then I guess their goal is to negotiate some of these aircraft and get them back into their fleet and ramp up. There are obviously valuable route authorities there that will be fallow for the time being. The fact is it is probably not in Brazil's best interest for those route authorities to lie dormant. Does markets like Lima and Bogota, which you have on your map. And I know some of these markets may be constrained by frequency, do you reconsider growth into some of these international destinations that can be profitably served by 737s?

A - Richard Lark {BIO 3484643 <GO>}

The short answer is yes. We do have plans. In August we going to be launching our San Diego base with a fair amount of flights -- a couple of flights per day. And we also have detailed studies on a variety of other markets that can be reached by the 737s, as you point out,, in countries like Peru and Columbia and so on.

Yes, those are in the plan. We know where we would want to grow to expand profitably in those international markets. Now I would say over the next 12 months we should definitely be expanding into those markets. But it is important to highlight that still in the short-term in 2006 the majority of our growth and capacity is planned in the Brazilian market.

Q - Michael Linenberg {BIO 1504009 <GO>}

But let's Bogota or Lima go on unserved over the next couple of weeks, would you be prepared to maybe move some of the aircraft that were allocated for domestic into some of those international markets because of the frequency is available and they are being unserved?

A - Richard Lark {BIO 3484643 <GO>}

We can do that as long as it is consistent with our network expansion model. The way we have a highly integrated route network. And we would not be doing direct flights from Sao Paulo to those markets. They would really be extensions and add-ons to our existing route network. Yes, we have the potential to do that. We also have the ability to do that with existing aircraft, which becomes a way for us to increase aircraft utilization.

A lot of our international flights today, keep in mind as well, are more of a -- a fair amount of them are night flights or they early morning flights or late at night flights or night flights -- night owl flights, which are a way for us to also increase aircraft utilization. Our international expansion to the extent it was accelerated in those markets would follow that type of network model.

Q - Michael Linenberg {BIO 1504009 <GO>}

Then turning to just another topic, you highlighted in your remarks about intense competition and how that impacted yields. Can you give us some color on that? Is that Varig sorted in their shrink mode trying to raise cash? Is that -- new carriers like OceanAir starting to fly bigger airplanes in some of the markets? What is going on there?

A - Richard Lark {BIO 3484643 <GO>}

I think it is mainly effects related to promotional activities from the large carriers. The small carriers are still pretty small and haven't had a big impact on that. What we saw in May and June was a lot of intense promotional activities from the big carriers. I think it is as simple as that.

Q - Michael Linenberg {BIO 1504009 <GO>}

And then just lastly, I had a quick question on the front page of your press release you talked about your on-time arrivals being 98%, which is off the charts. But then your completion factor being 94%, which is not off the charts. Is that right or are those numbers flip-flopped?

A - Richard Lark {BIO 3484643 <GO>}

Those are correct. The completion meaning the --.

Q - Michael Linenberg {BIO 1504009 <GO>}

You're canceling 6% of your schedule, is that --?

A - Richard Lark {BIO 3484643 <GO>}

It doesn't exactly work like that. It is basically you complete them within specific -- a specific amount of time delay. What happens in the GOL network. And it affects both sides of the equation, is because we have such a highly integrated network, if there becomes some slippage in the system because of a weather event or air traffic control congestion or so on, sometimes it makes more sense for us to reschedule those flights as opposed to create delays in the entire network. So part of it relates to the way we manage the network.

I guess maybe you wouldn't see that in other airlines that are doing much more -- that have higher turnaround times or a little bit more slack in their network. We're still doing 25 minute turnaround times operating in roughly 14 hours a day. And kind of at peak capacity.

Both of those numbers are from Brazilian market standard among the best. I think our punctuality during the quarter was the highest in the industry. We were the second-best in the regularity.

Q - Michael Linenberg {BIO 1504009 <GO>}

98% on-time is probably one of the best in the world. That is within fifteen minutes, right? Is that the standard?

A - Richard Lark {BIO 3484643 <GO>}

Yes. That's right.

Operator

(Marcello Luna) of Citigroup.

Q - Marcello Luna

This is Marcello calling on behalf of Steve Trent. We have a couple of questions. The first one relates to maintenance. It would be great if you could comment on whether the whole of the maintenance expenses in the Second Quarter were expected, or if there was anything extraordinary that was not budgeted initially. And still related to that, how that compares with your expectations for maintenance in the remaining of the year? That is the first question.

A - Richard Lark {BIO 3484643 <GO>}

The maintenance is scheduled -- the checks on the -- keep in mind we have roughly two categories of maintenance. One is what we call the line maintenance which happens every day -- a little bit every day. Then we have structural maintenance, which deals with the airframes, the engines, landing gear -- various of the big components of the aircraft.

Those are all -- of our very high aircraft utilization, it has to be very tightly programmed. And so in the past we have had some unexpected maintenance expenses because of a -- when you do a maintenance on a motor you might find that a little bit extra work needs to be done or so on. Maintenance in the Second Quarter was all previously scheduled maintenance. You pretty much project the maintenance events for the life of the aircraft when you're leasing the aircraft.

The experience with the 737 aircraft that we operate has been that the actual maintenance expenses have been less than initially projected. And it is a result of the aircraft technology specifically versus what was originally expected, as well as our own experience with operating the aircraft.

Going forward, this year we are more or less peaking in terms of average age of the fleet. A lot of the aircraft we have in now in 2006/2007, to some extent 2008 also, we will be going through the structural or the heavy maintenance. So maintenance expenses on an overall basis, on an absolute value basis, for the older leased aircraft will increase -- as in U.S. GAAP maintenance expense is incurred.

Having said that, at the same time we're bringing in over the next -- really over the next 14 months we're bringing in approximately 23 to 24 brand-new aircraft, which won't be having any heavy structural maintenance expenses for a couple of years.

When you look at it on a ASK basis, there's really not a big effect on an ASK basis. Also because we are increasing productivity, increasing stage length and sort of diluting those maintenance expenses over a larger base. But over the next couple of quarters maintenance expense on an absolute basis will definitely increase. But it is important to keep in mind on an ASK basis there's not going to be a big effect.

Q - Marcello Luna

The second question relates to airfares. We noticed that the airfares recovered a little. You're talking about average increases of 9.7%. And it might be a little too early to say. But I was just wondering if you could talk about your expectations in terms of the fares for the remainder of the year? Maybe GOL and your competitor have already been able to exercise some of its increased pricing power as a result of the further scaling down of Varig. Can you talk a little bit about airfares for the remaining of 2006?

A - Richard Lark {BIO 3484643 <GO>}

Sure. As you mentioned, fares in the quarter over quarter comparison increased. In our particular case the stage length, or the passenger trip week, increased at a higher rate than the fares have increased. We have seen in our service offering has been that the customers would prefer to pay lower fares. And for that they're willing to make connections.

We have over 50% of our passengers that make connections on our network. So as opposed to paying more for direct flights they prefer to configure themselves through our network to get the lowest fare regardless of the connection. Now that doesn't mean that there isn't an opportunity for us to add more direct flights; there is, to the extent that customers are going to pay for having the direct flight. Otherwise it doesn't make sense from a cost perspective. There's a little bit of that phenomena happening where low fares -- lower fares stimulating demand. And customers placing more weight on the overall fare as opposed to the convenience of a direct flight.

Another factor that has on the fare specifically, because we're not talking about yields, on the fare side specifically we have seasonality in our business. And Third Quarter July is one of the most -- the highest traffic month of the year because a lot of winter vacation travel. We expect very a strong demand environment for July and August and for most of the Third Quarter. And we expect that to continue until the end of year. On a demand side, combined with what is going on with capacity, it should support seasonality patterns consistent with what we have seen in the past.

Having said that, in the Second Quarter there was higher promotional activity than expected. We don't necessarily expect that in Q3. But we could see something similar in the September/October/November period being a function of the competitive environment. But demand has been as high as it has ever been in the Brazilian market. We have been growing at rates in the range of 20%. This year to date we're growing at -- having another year we're growing -- industry overall demand growing in excess of 20%.

There has been a large increase in leisure passenger travel. And that will continue as long as there still an offering of seats available at attractive fares. I would say you should expect to see similar seasonality patterns.

But there is a larger leisure component traveling today in the market -- as large as we have ever seen. And that leisure component is highly price sensitive. If average fares were to come up substantially, there could be a slight reduction on the demand side. But also keep in mind that the fare classes are segmented. And our strategy is to grow and make an increasing number of seats available at lower fares. We combine that would with the (you) management side of the equation, which is a function of basically matching supply and demand subject to competitive element to always maximize RASK. So we're always maximizing RASK given that set of demand plus the competitive factors.

But we do expect some competitive pressures to continue, meaning promotional activity, price competition to continue through the rest of the year, although not as intense as we saw in the Second Quarter.

Q - Marcello Luna

The last question relates to personnel. We noticed that there has been an increase in personnel in the Second Quarter. I was just wondering if you could tell us about the plans for remaining of the year. We know that with the ambitious capacity expansion that is something that will come together with the ASK expansion. But we just wanted to have an idea -- try to have a more clear idea of where your plans are in terms of increasing personnel.

A - Richard Lark {BIO 3484643 <GO>}

The growth in personnel is purely a function of the expansion of operations. We generally have a three to four month lead time on hiring and training people that are going to work in the aircraft and the airport basis. The administrative side of the equation is more or less -- is fixed. And so that -- we tend to have there is that is really a preview of what the capacity growth is. We had a big growth in the Second Quarter. And so that will get diluted or reduced to the extent that that capacity comes on.

Having said that, we're still going to be adding capacity for the following quarters. We should expect to see those employee levels and employee costs to kind of track next quarter's fleet growth for a couple of quarters. But it is a pure reflection of that.

On an ASK basis, on a employee cost per ASK basis our costs have remained pretty stable over time in (reage) because -- and we use that statistic as opposed to number of employees per aircraft, because we think it is a better measure of the productivity of the workforce. But there was a little bit of a blip in the Second Quarter given the fact that we are going to be adding six aircraft in the Third Quarter.

Operator

Ray Neidl of Calyon.

Q - Ray Neidl {BIO 14015874 <GO>}

I think what you have been saying is Q2 is normally your weakest quarter. But Q2 '06 was weaker than normal because it was harder to pass on higher fuel costs because of more intense competition. But you are still maintaining that you can do operating margins for the year of 26 to 28.

I'm just wondering in the second half of the year what makes you think that price competition will ease? And you have to really be aggressive in the second half of the year probably producing our operating margins of well over 28%, up towards 30%, if you're going to reach you that yearly goal. Is that an accurate summary of the situation?

A - Richard Lark {BIO 3484643 <GO>}

It is. It depends a lot on Third Quarter. And it depends a lot on rational pricing and rational competitive environment. There are structural limitations to how high loads can go. So if yields don't follow demand, everybody would basically be leaving a lot of revenues on the table unnecessarily vis-a-vis what the models tell you can be charged for pricing.

We saw a little bit of that in the Third Quarter of last year also, where we had loads go into the high 70s or pretty much 80%. And it could've supported a higher yielding environment. I think we're going to see that even more magnified in Third Quarter on the demand side. I mean, we are doing loads in the month of July here already in the 80s. And, yes, yields have recovered. They are up in the year-over-year comparison. But that will depend heavily on the competitive environment.

I would say that in a rational environment the yields could show as much as a 20% increase in the sequential quarter, meaning Third Quarter '06 to Second Quarter of '06, based on rational revenue management strategies on behalf of the industry. But a lot of that will depend on what happens in this particular quarter. But I think all signs are indicating that it should be a better quarter then we saw in the previous -- in the Third Quarter of '05.

Q - Ray Neidl {BIO 14015874 <GO>}

I agree. It seems like you're pretty much on solid ground here as far as earnings go. But if for some reason that the competitive landscape and Brazil does change a bit with this new Varig plan -- if these guys are successful and become a tougher competitor, that might put pressure on your margins and profitability going forward. If that were to happen would that cause you to change your growth plans?

A - Richard Lark {BIO 3484643 <GO>}

No, growth plans no, not all. As I said, our growth plans are based on where we want to positively grow our business, our network. And we need the aircraft to do that. So no. But the impact of what you're saying there would be -- could be lower than expected revenues due to suboptimal yield management or suboptimal revenue management on behalf of the industry. But we plan to be maximizing RASK, subject to the competitive environment. And maintaining load factors in the Third Quarter here in the mid to high 70s and basically fill our planes in as profitable a manner as possible.

Q - Ray Neidl {BIO 14015874 <GO>}

Can you just give us an update on the stock deal you were supposed to do at the end of June. Is that put off indefinitely or is that still pretty much coming?

A - Richard Lark {BIO 3484643 <GO>}

As I said, we haven't launched the offering. We haven't found appropriate market conditions to launch the offering. I wouldn't say it is on hole. I wouldn't say anything other than we just having launched it yet ,be we still do have plans of at the appropriate time executing that offering.

Operator

David Strine of Bear Stearns.

Q - David Strine {BIO 1541055 <GO>}

A question on the guidance for both the remainder of 2006 and 2007. Are there any specific assumptions there with respect to the size of your competitors? And then second, what stage length are you assuming in those periods?

A - Richard Lark {BIO 3484643 <GO>}

There is no specific assumption on -- because we don't really manage that based on market share. It is basically -- it is a function of expected demand growth and our own final analysis of where we can add to our network. Obviously, as we're going forward here as GOL becomes larger and GOL ends up having a big influence on the overall market growth -- and I think it is a good interesting analogy to look back to the U.S. maybe in the 70s where -- and try to draw some parallels.

We still only have 8 million consumers of passenger air transportation in Brazil. When GOL started maybe it was 5.5. When we started we mapped out a strategy that the market could go to 20 million. And so in our view we're just running along smoothly, maybe a little bit ahead of plan. But running along smoothly to the point where we can get to market a 20 million consumers and at least 60, if not, 70 million in (planements) per year. That is really where we are executing.

Yes, there is a big focus on market share. There is a big focus on the pie. But the pie is expanding, last year, this year, at a rate of 20% which we think is a secular phenomenon. In response to the second part of your question and on the stage length, '07 would probably be a 3 to 5% increase in stage length over '06 -- a small increase in stage length. Part of that relates to adding a little bit -- maybe a little bit more direct flights. And then also the international flights. But a stage length in the range of 840 kilometers or so for '07.

Q - David Strine {BIO 1541055 <GO>}

For the back half of '06, still around 800?

A - Richard Lark {BIO 3484643 <GO>}

For the back half of '06, stage length around -- no, I would say 800 yes for Q4. But Q3 probably around 830. Because we tend to -- in Q3 -- in the high season we adjust the network a bit to take advantage of the seasonal traffic. And in our part of the world here there is a lot of people in the colder part of Brazil and South America that want to go up to the northeast of Brazil for the beaches and so on. So we add some more longer-haul flights -- or flights that have some longer stage lengths than the July/August period.

Q - David Strine {BIO 1541055 <GO>}

A brief follow-up on something that Ray had asked about, if I may. I think in your response with respect to how yields were behaving, I just want to be clear, did you mention that sequentially following the significant pull down in capacity from Varig that on a sequential basis yields began to tick up about 20%? And if nothing really changes that could be the pattern that we see through the Third Quarter?

A - Richard Lark {BIO 3484643 <GO>}

I would say our models based on what is happening currently show a potential, if you go sequentially Q2, Q3 the yields would be up -- could be up as much as 20%, which I guess would be up roughly 8 to 10%, or 8% over the Q3 of last year.

Q - David Strine {BIO 1541055 <GO>}

I just want to try to get a feel for it. I know there's no perfect answer but in terms of the swing factor on all the volatility that you're seeing from the Varig capacity, how would you quantify it, or can you? How much is it affecting your ability to manage yields?

A - Richard Lark {BIO 3484643 <GO>}

You're meaning the competitive factor? It is important to keep in mind here Varig has a very small -- keep things in perspective, Varig has a very small portion of the overall capacity today. And an even smaller portion of the -- if you look at seat share in the month of June they were around 12, 13% on seat share and 10, 11% on market share.

And they have been reducing capacity. So if you get to look at the larger competitors and what they're doing on pricing to understand how that might go. In our particular case, in the case of GOL we see there is demand to be able to, through rational revenue management strategies, to have yields in Q3 increase 20% on an average over Q2. But that is going to depend on what the other large airlines do in terms of their own revenue management strategies, which doesn't depend on us.

Pretty much since the end of the TAM Varig co-chair back in May of last year pricing, overall industry pricing, has been determined by that dynamic. It has been determined by the Varig TAM dynamic. You could argue that before that GOL had a much stronger influence in terms of being a price setter or price leader. And that has depended on other factors over the past year or so.

Q - David Strine {BIO 1541055 <GO>}

Since the more meaningful pullback in their capacity that occurred at the end of the quarter, or closer to the end of the quarter, that has not been -- you're saying that it is not been the most -- or the major driver of the sequential yield performance.

A - Richard Lark {BIO 3484643 <GO>}

You mean improving in July, is that what you're referring to?

Q - David Strine {BIO 1541055 <GO>}

Correct.

A - Richard Lark {BIO 3484643 <GO>}

The main factor on that is seasonality -- increased demand -- better-than-expected demand. And through yield management basically the supply and demand pulling that up. When we get to load factors, industry load factors are also running in the high 70s in the month of July. So there has been a natural tension for yields to be gone up. But we saw in Q3 last year -- we saw a similar pattern with very good demand. But suboptimal pricing. And so a lot of revenues were left on the table. We haven't seen that.

Here in the third week of July things have been increasing as a function of the seasonality. We will have to see what happens in August and September when a little bit of demand pulls off from the July period. But our models show very, very good demand. And there is room for pricing to improve given the demand.

But having said that, we're adding a lot of capacity in the third and Fourth Quarters of this year. And we would like to see loads in the -- I think loads in the mid-70s would be a nice, healthy way to get through the end of the year combined with healthy yields. We can also see the situation in the Third Quarter where we -- if you are dealing with a situation where pricing is more aggressive than expected, we would have a situation where we would be operating at 80% loads for the quarter. Always trying to maximize RASK in that environment. But I think that rational environment will depend less on us and more on what the other large airlines do.

Operator

Rodrigo Gomez of UBS.

Q - Rodrigo Gomez {BIO 19849926 <GO>}

I am wondering if you could comment a little bit on this decision by VarigLog to focus on the Rio, Sao Paulo shuttle and pretty much stop everything else, which seems to me like it will put the burden on you and TAM for a little while. I guess it shouldn't be too much for burden since I can't imagine a lot of people buying a Varig ticket nowadays.

But do you think that the -- do you plan to launch a formal complaint with the regulator? What do you think the regulator will do? It seems like it is a bit unfair. But I don't know if they're going to be able to get away with this or not. What is your view on that one?

And do you what think will happen with their remaining concession rights going forward? Do you see them losing part of them? It doesn't seem like they're going to have enough planes to take care of all of their concession rights. Do you expect to get them on a permanent basis? That was the first question.

A - Richard Lark {BIO 3484643 <GO>}

It is really different difficult for me to comment on their plans because we don't have -- there's not a lot of clarity on that for us (inaudible). So it is really difficult for me to comment on that. There has been a lot of back and forth on plans there over the last couple of months. And I would expect that there is still is going to be a lot of back and forth going forward. It is really difficult for me to comment on that.

But in terms of how the overall industry in terms of operational slots, there are rules with maintaining a minimum level of regularity below which you lose slots. You cannot just sit on slots and not operate them, especially in an environment where there is such high demand in the industry it becomes a public transportation problem in Brazil. What happens there is going to depend on the regulator enforcement of what the rules are, which is also a difficult for me to comment on.

Q - Rodrigo Gomez {BIO 19849926 <GO>}

With regards to fuel, the impact of fuel has hit your numbers above the line, is that correct?

A - Richard Lark {BIO 3484643 <GO>}

On the operating side?

Q - Rodrigo Gomez {BIO 19849926 <GO>}

Yes.

A - Richard Lark {BIO 3484643 <GO>}

Yes. We have had -- yes, the fuel impact -- the majority of the fuel impact has been -- I assume you're referring to hedging gains. Is that what you're referring to?

Q - Rodrigo Gomez {BIO 19849926 <GO>}

Yes.

A - Richard Lark {BIO 3484643 <GO>}

A portion of our hedging gains are recognized in operating expenses, a portion are in financial expenses. And it depends on the FAS 133 treatment of whether or not your hedges were deemed effective or not. In Q2 extraordinarily we had a little over $R16 million of gains that were in -- are in the financial income line.

If you wanted to do a nonaccounting calculation, you could put those 16 up in the fuel line and calculate it differently. But in terms of what is in the operating line, I think that is a fair measure of the operating effects minus the hedge effect for the fuel in that quarter.

If the hedging gains that were realized in Q2 in the financial line related to the hedge positions there were there at the end of the quarter. They were hedges done for future consumption. We realized a lot of gains on those because we launched the hedge accounting treatment on those hedges. Obviously, it is economics. It is real. It also has a cash effects. But it is -- I think it should be excluded from the operating margin calculations.

Operator

Jamie Baker of JP Morgan.

Q - Jamie Baker {BIO 3406456 <GO>}

I guess this question continues on an earlier theme. But if you throw out fuel expense altogether, your margins did fall from the First Quarter to the second, despite another 400 basis points of Varig marketshare decline. I realize there is seasonality from Q1 and Q2. But last year the decline for you was about the same, yet Varig was almost twice as big. And they were losing share as quickly. To the untrained eye this implies that Varig's difficulties haven't even benefited you yet. Any thought on looking at it this way?

A - Richard Lark {BIO 3484643 <GO>}

Well, I think a couple of comments. One is that on a -- if you look at it on a dollar basis, most of the effects on the dollar -- the correlations with the U.S. dollar exchange rate and yields and revenues have remained pretty high, close to the 70% range. So the pass-through on the dollar side has impacted the revenue side.

We had an appreciation on the exchange rate of 12% quarter over quarter. So that acted as a downward pressure on -- there is a benefit on costs. But then also acted as a downward pressure on the revenue side. What didn't really happen in Q2 was up until Q2 this year -- up until the end -- until the end of Varig TAM co-chair last May, we still had a very correlations on the fuel side. We still had a 70, 80% correlation with yields and fuel prices.

Pretty much since that period in time those correlations have been pretty much reduced to zero, which has had important implications for our hedging program. So (inaudible) well. We haven't seen is the industry pretty much in the past 12 months or since June of last year has not past through -- June, July of last year I guess to be more accurate -- has not past through the fuel effects. Where we had historically been -- it didn't happen there. There was a slight benefit on -- if you look at yields on a dollar basis, yields year-over-year or quarter over quarter on a U.S. dollar basis are up. The exchange rate appreciation was greater than the yield reduction. But the fuel and it was not past through.

I would say at one point to keep in mind is that we have not benefited from the ability to pass-through fuel cost increases since the end of the Varig TAM co-chair. But on the other side of the equation what I would say is there has been a substantial increase in the traveling public here in Brazil, which is what has been needed and required for a very, very long period of time.

That has only been made possible by having a larger number of seats available at more attractive rates. We would like that trend to continue. We don't think it is appropriate for our business and for the overall industry growth to be that focused on increasing yields at this point. We think it is much more important to be growing the size of the market. And in our particular case installing the capacity to be able to service this larger market. We find that much more interesting than really trying to focus on this yield margin dynamic.

So a lot of what has been happening on the gross side has been volume without as much fuel as we have seen in previous years. But given the tradeoff here, we are pretty happy with the way things have been developing in terms of the overall volume growth, the new passenger creation gross, getting our installed capacity in terms of aircraft and new basis. It is really the right time to be doing this now and not focused on -- if yields were to come up spectacularly here in the near term, the risk would be that all this growth could disappear. And then we would be back to the situation or basically who is traveling in Brazil is just 5 million business travelers per year that can afford to be flying, which is not what the GOL model is all about.

I would just like to put that into perspective. Obviously we're working really hard to control costs. And we're going to have to work really hard to meet our objectives for this year. That involves being very, very careful about how we maximize RASK in the context of what is going on in the competitive environment. But it is tough -- the only thing I would link to the Varig situation was when the Varig TAM co-chair ended, financially what we see is that what happened was we lost the pass-through on the fuel side of the equation. But pretty much all the economic characteristics that we had in our business model, including the this RASK correlation with the dollar exchange rate have been maintained.

If you just look at the dollar affect yields, if you will. And margins in dollar terms are actually up in the year-over-year basis. There still has been the benefit of the exchange rate in our financial results has been present, albeit at margin levels that if you go back two years before were lower in Q2 of '06 than say Q2 of '04. But we were in a very different environment in '04 than we are now, both in terms of exchange rate environment as well as the competitive environment.

Q - Jamie Baker {BIO 3406456 <GO>}

That is helpful coloring. Secondly. And I apologize if I missed this before. But for the newly introduced 2007 guidance, what is your fuel cost assumption?

A - Richard Lark {BIO 3484643 <GO>}

Our fuel cost assumption for -- behind that 27 would be roughly a 3 to 4% decrease from the reduction from '06. But with an exchange rate assumption of around 2 to 3% above --

meaning a 2 to 3% depreciation in the real, instead of something in the 225 to 230 range for '07. That would put fuel in the -- I don't know roughly somewhere between 165 and 170 per liters in real. But it is important to mention that the two things are linked there, meaning the exchange rate being linked to that. (multiple speakers).

Q - Jamie Baker {BIO 3406456 <GO>}

Understood.

A - Richard Lark {BIO 3484643 <GO>}

That is probably to point I was -- well, it is probably, at least from what we've seen, that is a much more conservative assumption on oil prices than we are seeing in the market. We are seeing projections for next year that get down to roughly $45 a barrel. We are using a per barrel assumption much higher than that in our models. We might be erring on the very conservative side on the fuel price assumption.

Q - Jamie Baker {BIO 3406456 <GO>}

I would be curious to see who is forecasting 45. But in any event, let's hope they are right. Richard, thanks a lot. I appreciate it. Bye-bye.

Operator

Jander Medeiros of Pactual.

Q - Jander Medeiros {BIO 7255199 <GO>}

Actually most of my questions have been answered already. Just one remaining question. It seems that your (inaudible) RASK have been a little bit more volatile than for competition. I mean in 2Q '05 and 2Q '06 your then RASK dropped more than for competitors. And the opposite happened for instance in Q2 '05 -- in Q half '05 -- in the second half '05 your then RASK went up by more than for competitors. Do you believe this is a pattern for the next couple of quarters -- next couple of years? Are your high volatility coming down in 2Q and coming up in the second half of the year?

A - Richard Lark {BIO 3484643 <GO>}

I would say two effects. One is that I think if you look the other way around from a competitive perspective, competitors have improved a bit their yield management practices. So they have closed the gap on yield management you could argue, I think, between GOL and some of the other competitors.

We saw -- up until the point you mentioned, GOL actually -- even though GOL has I think a perception as a discount airline, GOL was doing RASKs sometimes at a premium to competitors that in theory have a more premium value proposition. I think that to some extent that gap maybe has been closed.

I would say we have seen the relative volatility -- from where we stand, no, we don't see a big change in terms of the pricing for our products for customers. Perhaps what has been happening is that competitors have narrowed, or are now in a situation where perhaps they are able to get a premium over GOL on the yield side as a result of their yield management practice.

The other thing that we've seen in the first six months of this year has been an increase in the VFR visitors, friends and relatives in leisure passenger market. The big growth that is happening is not because business travelers are traveling five times more than they were traveling before. Yes, there is an increase in business traveler traffic. But historically that business traveler traffic tends to grow at two times GDP and reflects economic growth and so.

What we have seen is a good big growth in the VFR called the flexible passenger market, as well as the leisure traveler market, which is very exciting because it represents the increase of the customer base. And we have been a big driver in that effort in terms of a lot of the expansion and a lot of the growth in capacity and the focus on popularizing air travel in the market has benefited us.

And arguably that also has an effect on yields because the incremental growth, when you go from a 60% load factor to an 80% load factor the incremental growth, while it is all net income positive is, albeit, at lower yields. Part of what is in there has been a very high growth of the leisure market in recent quarters versus what we have seen in previous quarters when we and everybody were pretty much just dealing with the business base, which I guess to put in your terms is probably less volatile on the yield side.

But keep in mind that the leisure and travel market is much, much, much more price lasted, whereas the business travelers are pretty price inelastic. The leisure market has a very high elasticity to the price, maybe as much as three times.

As that jump, if you will, in the leisure passenger customer base happened you could argue over the last 12 months substantially, that probably also explains what you're noticing there in the delta there where you compare us versus to our competitors.

Q - Jander Medeiros {BIO 7255199 <GO>}

Could you tell me how much those clients, the VFR, the leisure market represented in Q2 -- the percentage of your travelers, an idea?

A - Richard Lark {BIO 3484643 <GO>}

We're probably seeing as much as -- if you take the first six months of this year we're probably seeing 40% of our volumes are flexible plus leisure traveler. Leisure meaning obviously very highly related to vacations and tourism. But it is important to highlight this flexible passenger market. These are people that aren't traveling for vacations, they are traveling because they have to travel somewhere. And they would go by car, bus, or plane depending on the price point. That overall, whereas in the past maybe we had seen 30% of the flows being from that segment, that has probably gone in the first half of this year to 40, maybe even as high as 45% of the total flow.

Operator

(Gonzalo Mendez) of Millenium Partners.

Q - Gonzalo Mendez {BIO 21301216 <GO>}

Could you talk a little bit about, given your cost advantage, why don't you explore other international markets like Europe and the U.S.?

A - Richard Lark {BIO 3484643 <GO>}

Our network strategy today is based on the -- in other words, our route strategy today is based on the 737 aircraft, which has a range of maybe 5.5 hours max. So to serve longer -- we don't have an aircraft that is appropriate for doing longer-haul markets. Nor do we -- in the studies we have done, I find that interesting. It is very difficult to get a high-level -- for a Brazilian company to get a high-level aircraft utilization with a long-haul aircraft to U.S. and Europe.

And the markets that are -- the other markets that might seem logical because, yes, you can fly 737 aircraft with one stop from Sao Paulo in Northern Brazil to Miami. Some of those closer markets are hyper competitive and very, very price sensitive, where it is very difficult to make -- at least in our analysis and our model -- it is very difficult to make interesting profit margins in those markets.

This doesn't mean that over the years as the GOL network expands that that won't present opportunities to enter into these other markets. But in our plans not with long-haul aircraft. It would always be with the short-haul aircraft. To the extent we can find a way to do that and make interesting profits out of that, we certainly would do it. But if we look out over the next couple of years here that is not in the plans.

Operator

Travis Anderson of Gilder Gagnon Howe.

Q - Travis Anderson {BIO 16488149 <GO>}

A comment on that $45 oil number. That would mean a (inaudible) of recession. So I'm not sure I'm in favor of it. But I was wondering whether you are honoring Varig tickets. And what kind of pricing there is on those in terms of is that hurting your yields significantly, or are you able to get some sort of supplemental price from those people, or how does it work down there? I don't know --?

A - Richard Lark {BIO 3484643 <GO>}

We have been -- obviously we have been -- in the recent weeks we have been helping out and assisting with the obligation we have as a provider of public transportation in Brazil, with transporting passengers on our flights. Obviously, they are run through existing flights and put in seats CEPS to help accommodate those passengers.

There really hasn't been a big impact in terms of the overall numbers. I don't think we've had a day where it has been more than 300 passengers a day that we have been accommodating. Obviously, this is a secular thing meaning that all the airlines help out. That is one.

Two is that normally in a normal course of business we -- airlines transport each other's passengers. If you have a canceled flights or a problem in the system, we accommodate each other's passengers on our basis. So there is a clearinghouse system in Brazil where all the payments are settled.

Q - Travis Anderson {BIO 16488149 <GO>}

Have they been paying?

A - Richard Lark {BIO 3484643 <GO>}

Yes, they have been operating in that system and they have been -- I can't say they have been current on obligations. But they have been paying as agreed in the system. But it is important to highlight the first point which for us it really hasn't a big amount. It is a very tiny amount of liabilities there.

Q - Travis Anderson {BIO 16488149 <GO>}

The other thing, on this change that they announced today of dropping everything else but Rio, Sao Paulo and going to 36 -- is that round trips a day? I'm not sure. But I assume they have the slots for that?

A - Richard Lark {BIO 3484643 <GO>}

They have their -- I guess sitting on whatever slots that they had their original ones. I guess it could be part of their strategy was trying to find where they want to shore up their network.

They had in recent months migrated more of their flights to (inaudible), which I guess was meant to basically maximize their ability to do the last mile for passengers coming in on their international flights.

As I was saying before, it is tough for us to comment on that because there's not a whole lot of clarity on what the specific plans are. I know there has been a lot of comments in the press. But I think we are going to have to wait and see what actually really does happen. And what de facto really happens with what they're going to be doing there. It is highly -- I think we would just be speculating from our perspective.

Q - Travis Anderson {BIO 16488149 <GO>}

Taking their press release at face value, at least from the way it was translated up here, they did say that their goal was to get back to all 80 aircraft and service eventually. I don't remember if they gave a timeline or not. But it sounds like that might be a little more capacity overall than the market could handle if they do that over the next 12 months.

A - Richard Lark {BIO 3484643 <GO>}

Keep in mind as well, rules about capacity expansion here -- the only thing that has been really liberalized in recent times, is you can bring in aircraft -- you can import in aircraft without specific route approvals. But you can just park them in your garage then. It doesn't necessarily mean that they're going to be flying those -- that any company that would announce a capacity plan is going to be flying those. It has to be subject to route approvals. And then how the regulator is going to deal with authorizing that and supply demand management. It is tough to speculate on the probability of that actually occurring.

Q - Travis Anderson {BIO 16488149 <GO>}

They don't have to -- they have to get approval to go back and operate routes that they were previously operating?

A - Richard Lark {BIO 3484643 <GO>}

It is not as simple as that. Yes, if you are maintaining a -- if you have a route that you have the route authorization for and you are (multiple speakers).

Q - Travis Anderson {BIO 16488149 <GO>}

But you haven't been flying it for the last six months or so or --?

A - Richard Lark {BIO 3484643 <GO>}

That's the thing. Not flying it for the last six months, that is where you get into the gray area. Roughly with the regularity rules the way they are, if you're not operating a route or a spot for a period of a couple of months you would lose that route, right, if somebody else requests it. And so a lot of it is going to depend how the regulator approaches that aspect. And we don't -- we are not allowed to set on -- get capacity approvals for routes and then not operate them. You have to operate them within a very short period of time of getting the capacity approval.

What has changed in recent times is you can bring in -- you can import aircraft without having the specific route approvals. And that was done to facilitate -- it was very difficult to go out, as you know, to go out and get an aircraft, sign an agreement. And not know exactly if you can actually bring it into Brazil or not. That was liberalized to allow -- making it a little bit easier to source aircraft. But doesn't mean you have got a route approval for that.

With regard to existing routes, that is going to have to be sorted out by the regulators specifically what is going to happen there. I think it is not a reasonable assumption to think that there is going to be 16 of your aircraft flying round route rights over the next couple of months here. To the extent that would happen, I think it would be much more gradual process.

We don't see the regulator interested in creating a huge distortion in terms of supply and demand, given all the good work that they have done over the last couple of years. People have short memories. But if you go back four, even as long as three years ago, the industry was struggling to have a 60% overall load factor, which was still below overall industry break even.

Over the past two or three years capacity has been managed to correct that disequilibrium such that for the most part today over land industry load factors have been tracking ahead of break even load factors. That has brought back financial equilibrium to a sector that for many, many years was subject to huge losses unless you had super low costs.

We don't see anybody wanting to undo all that good work that has been done over the last three years in terms of creating a healthy, albeit, strengthening although not as strong as it needs to be yet, an industry which is of vital importance to the Brazilian economy and so on and so on.

We think it will still be managed within that umbrella of controlled monitored --, monitored capacity expansion so that the industry is not put back into the situation it had if you go back four or five, six years. But there has been a transition in terms of the regulatory authority over the first part of this year. There has been this industry transformation event which has been happening in terms of the competitor environment.

But I go back to what I said at the beginning. For us the details are not really clear enough to be able to understand exactly what could potentially play out here in the short term. I think we are going to have to wait until the dust settles and understand a little bit better exactly what the intentions of the new owner of the MatlinPatterson is of that company. What exactly they're intentions are versus what has been discussed in the press, because there has been a lot of anxiety over that situation.

Q - Travis Anderson {BIO 16488149 <GO>}

As a political cynic I was would expect their maximum leverage is from now until the election.

A - Richard Lark {BIO 3484643 <GO>}

Yes, there is probably something to be said for that. It is an election year in Brazil in October. There are a lot of jobs there at Varig. Clearly the government in its capacity is concerned, rightly so, about passengers, transportation and about jobs. The passenger transportation aspect is going smoothly. And then there is the job issue as well. Yes, I think you're right, there is that aspect to be dealt with.

But our assumption here is that there are still going to be efforts to try and manage the overall industry in as sound a way as possible to keep it financially healthy and strengthening. Because we're still not entirely out of the woods in terms of the overall financial health or strength of the airline sector in Brazil.

Operator

(Operator Instructions) Fabio Zagatti of HSBC.

Q - Fabio Zagatti {BIO 3846027 <GO>}

I don't know if we're running off time. But if you don't mind, I can leave my questions for the (inaudible) conference call. What do you think?

A - Richard Lark {BIO 3484643 <GO>}

(technical difficulty).

Q - Fabio Zagatti {BIO 3846027 <GO>}

Okay. So I will do this. A couple of quick questions. As a follow-up on Varig. What would be the plan of the guys from Varig who wanted the company to become an LLC with the brand Varig? I see you maintain your guidance for '06 and showed us strength for '07. Are you predicting these years anything regarding the possibility of competition based on your model? And let me do this in a different way. Could you disclose what sort of market share you suspect you will have by 2007 year-end?

A - Richard Lark {BIO 3484643 <GO>}

As I said before, we don't really -- I don't have a single model that works based on market share. Our revenue projections are based on what we expect to be happening in the markets that we operate. And based on our plans in terms of building a route network. You know, routes in those markets, a very detailed bottom-up analysis that market share ends up being an outcome of that.

There's a lot of data that shows basically one of the key motors of the market growth today is GOL. So we're getting a larger proportion of the incrementally new passenger. But we don't make any assumptions on what these other guys may want to try to do. At the end of a day, we just stayed focused on trying to have the lowest cost possible, which are going to be facilitated by -- a lot by our business plan over the next couple of years. It is heavily dependent on the new aircraft we are going to the operating. And then continuing our network and route management strategy, revenue management strategies. It is not a big input necessarily what is going to be happening on market share and things like that.

Q - Fabio Zagatti {BIO 3846027 <GO>}

Would you be surprised, or would you get back and change plans if next week the guys from VERIG disclosed that they are now following the LLC model?

A - Richard Lark {BIO 3484643 <GO>}

If we did our planning on that we would have changed -- we would have stopped operating in January 2001. Because this is a weekly, a monthly phenomena in the business. The answer is no. Like I say, our planning is not -- our capacity planning and business planning does not depend on those types of events.

Q - Fabio Zagatti {BIO 3846027 <GO>}

If you will allow me another one, if you don't mind. What is the idea behind the conversion of a part of Junior's (owing) shares into preferreds? Truly I would totally understand if you don't feel comfortable to disclose this. This is his reasoning. But do you have anything to share with us?

A - Richard Lark {BIO 3484643 <GO>}

No, it is already disclosed. All the goals are very transparent in terms of -- especially at the controlling shareholder level. Over last couple months they have gone through a restructuring of their holdings for a variety of reasons, which has to deal with their own particular situations, tax planning, things like that. It has nothing to do with GOL.

Q - Fabio Zagatti {BIO 3846027 <GO>}

So he is keeping the shares even after conversion, all right?

A - Richard Lark {BIO 3484643 <GO>}

That is correct. Yes.

Operator

(Victor Fellis) of ICATU.

Q - Victor Fellis

I would like to ask, you mentioned before that your yields were apparently exchange rate linked since they are not fuel linked. My question is, if exchange rates go up, the depreciation of real in Brazil, would you be raising (inaudible)? And a complementary question to that, if by any chance market demand does not meet your expectations for the following year, would you lower yields further to meet that demand?

A - Richard Lark {BIO 3484643 <GO>}

I am not sure understand your question. The first part of your question was -- well, it is not a question of being late. There's a question of correlations. Because the cost structure of our business is over 50% dollar denominated, or dollar linked, there's an impact of the exchange rate on the cost side of the equation.

Historically that has produced a very high correlation with US dollar exchange rates in the order of 70, 80% as the industry passes on those exchange rate effects from their cost base to their revenue to customers -- to the revenue side of the equation. Yes, given that the cost base is still going continue to the highly dollar-related, we expect that that correlation will continue.

Historically the same phenomenon has happened on the fuel side. What happened in the last six months of last year has continued -- has been extremely volatile -- or ahead of expectation increases in fuel have not been passed on to -- fully passed on to fares. Therefore the correlations have been very been very poort. I'm sorry, the second part of your question was?

Q - Victor Fellis

If demand doesn't need your expectations for the following year, you're going to end up with a whole bunch of aircraft with perhaps a lower utilization rate. Would you then lower yields to -- well, to the higher -- your utilization rates or to use these aircrafts?

A - Richard Lark {BIO 3484643 <GO>}

What you're saying is almost impossible. If anything it is the other way around. We're not going to end up with a bunch of aircraft sitting around. We have a -- our business plan in terms of capacity growth -- supply growth in our business is based on specific markets and specific routes where we have those aircraft on an incremental basis. It is done together with the demand requirements.

We have the ability to -- another way of answering your question would be the following. If there were an event that happened in Brazil that for some reason drastically reduced air traffic demand, how could we deal with that? How could we reduce capacity? It would basically just be a function of letting leased aircraft expire and return to lessors.

We have -- the majority of our order with Boeing -- the deliveries of those aircraft are timed to basically sync in with the expiration of leases. So as opposed to renewing leases or to releasing aircraft or getting other leased aircraft in addition to our purchase order, we could simply not do that portion. And we would naturally reduce. But that will always be calibrated very, very closely.

Historically what we have been doing has been constantly increasing. And we have an increasing greater need for aircraft. It is based 100% on our expectations of demand and our analysis of demand.

But your question on the fare side is actually the opposite. We would not have a situation of lowering fares to fill empty aircraft. What you would adjust -- you would just the denominator there basically. You would adjust the ASKs that you have out there to the overall number of aircraft you have in your fleet. We wouldn't be reducing utilization, nor we would we be reducing fares simply to fill aircraft. Although I by understand that that phenomenon happens in a lot of markets around the world. But that is -- our business model -- our operating model doesn't work that way. It doesn't permit that.

It is a flexible -- we do have a flexibility to adjust the denominator, because we have such high growth in the number of aircraft -- one per month in some months, two per month, it is fairly easy for us to reduce capacity should we need to do that.

Having said that, our situation that we see is actually the opposite. We foresee greater needs to increase capacity to effectively serve the demand that is going to be out there on a profitable basis. I understand the basis of your questions, because I think you do see in a lot of markets such as the U.S. in the past I guess the inability of companies to be flexible on their fleet.

But keep in mind as well, we operate in a market which has a very low penetration of air travel. And what you would see in a scenario where the industry was reducing capacity you would actually see a situation of increasing yields, if you could try to understand that. Because in a situation of reducing capacity where demand is falling off. And demand being the flexible and the leisure traveler, that just would increase the relative proportion of business travelers flying in the market, which are price insensitive.

And so the overall mix in terms of yields would actually increase in that market. Which is why I am saying the scenario you're highlighting there would actually be the opposite. Fares and yields would actually be increasing in the face of a shrinking market, if you can understand that logic. That is because we are still dealing with a very small market, which is still very highly business travelers.

Operator

Seeing there are no further questions, I would now like to turn the floor back to Mr. Lark for any closing remarks.

A - Richard Lark {BIO 3484643 <GO>}

Thank you, very much for your attention today and your interest in GOL. We will remain committed to our goal of making air travel a simple and more convenient and accessible experience for everybody, while creating value for our shareholders and employees.

GOL is popularizing air travel in South America and Brazil through the expansion of our business, innovation and our quality of services, operating efficiency, cost management and competitive low prices. At GOL our slogan is, Here Everyone Can Fly.

If you have any additional questions, feel free to contact our Investor Relations department. And you can also visit the Investor Relations section of our website at www.voegol.com.br/ir. Thank you, very much. And have a nice day.

Operator

This does conclude today's GOL conference call. You may now disconnect your lines and have a wonderful day.