Q4 2016 Earnings Call

Company Participants

- Paulo Sergio Kakinoff, President, Chief Executive Officer & Director
- Richard Freeman Lark, Chief Financial & IR Officer

Other Participants

- Duane Pfennigwerth, Analyst
- Felipe Vinagre, Analyst
- Lucas Barbosa, Analyst
- Matthew Fallon, Analyst
- Pablo Zaldivar, Analyst
- Paul Lukaszewski, Analyst
- Petr Grishchenko, Analyst
- Savanthi N. Syth, Analyst
- Victor Mizusaki, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Welcome to the GOL Airlines Fourth Quarter 2016 Results Conference Call. Today's presentation will be made by Paulo Kakinoff, GOL's President and CEO; and Richard Lark, GOL's EVP and CFO.

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.

This event is also being broadcast live via webcast and may be accessed through GOL website at www.voegol.com.br/ir and Engage-X platform, where the presentation is also available. Participants may view the slides in any order they wish. The replay will be available shortly after the event is concluded. Those following the presentation via the webcast may post their questions on the platform, and our questions will either be answered by the management during this call or by the GOL Investor Relations team after the conference has finished.

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

At this time, I will hand your call over to Paulo Kakinoff. Sir, Please go ahead.

Paulo Sergio Kakinoff {BIO 5160310 <GO>}

Good afternoon, ladies and gentlemen. Welcome to the GOL Airlines fourth quarter 2016 results conference call. I am Paul Kakinoff, the Chief Executive of GOL. I am joined by Richard Lark, our Chief Financial Officer.

Both the press release and slide presentation are on the GOL website and I would urge everyone to make sure you have had a look at that. Richard will take us through the quarterly results in a few minutes, and I will give you a couple of brief summary remarks.

In 2016, GOL achieved the number one position as the largest airline in Brazil as measured by market share of RPKs and passengers transported. We are Brazil's favorite airline, having carried almost 400 million passengers since our first flight in 2001. In 2016, over 32 million passengers chose to fly GOL and our forward bookings and traffic are rising.

GOL is recognized by customers for having the most attractive flight network in Brazil. There is a shift in (03:05) punctuality and the best customer experience and service. Our fleet of 120 Boeing 737 aircraft and an order for another 120 Boeing 737 MAX will allows us to maintain the lowest operating cost of any airline in Brazil. GOL has a team of more than 15,000 skilled aviation professionals, delivering the region's best on-time performance and an industry leading 16-year flight safety record.

Please move to slide number 3. This morning you have seen we released the fourth quarter numbers, showing that we recorded a net loss of BRL 30 million for the quarter. We achieved an operating margin of 7.4% in the quarter and 7.1% for the full year 2016. Our pre-tax income margin was 1.3% in the quarter. Our EPS was a loss of BRL 0.09 in the quarter or $0.003 per ADS.

Fuel costs fell 17% per ASK in the Q4. Non-fuel unit costs, excluding non-recurring expense were down 7%, as we grew load factors and benefited from dollar weakness on some parts of our cost base. Our low cost base continues to be the key differentiator with all other lines. Not only had we the lowest operating costs, but as this gap widens, we'll be continuing to deliver an even better value proposition through customers to ensure we grow safely and profitability.

On-time performance in the quarter was solid at 94%; and in 2016, GOL was recognized as the most punctual airline in Brazil by the OAG, Official Airline Guide. Our load factors were at 78% in the quarter, up to 2.2 points over 4Q 2015. We returned five aircraft in the quarter and reduced our ASK capacity by 6% year-over-year, and reduced our number of flights by 20% year-over-year, allowing us to match our supply with Brazilian economic conditions.

The balance sheet continues to improve. In December, we moved to a net debt position of BRL 5-point billion. GOL's leverage pro forma for aircraft (05:48) in the first quarter of this year is now close to 4 times.

Please switch to page 4. In the quarter, average fares increased 19%, while traffic decreased 15% to 8.1 million. I also highlight a 6.6% increase in our unit revenue quarter-over-quarter. The RASK was almost BRL 0.23.

During the fourth quarter 2016, we've returned five aircraft as we continue to match our capacity, route network and bases to adverse Brazilian economic conditions, and at times when some other airlines are growing capacity despite the Brazilian recession. Accordingly, our price environment has improved, but we still have economic and political uncertainty.

Slide number 5, please. Here you see that the reduction in our fleet permitted a 6% cut in ASKs and 20% reduction in the number of flights. ASKs included 2.6% in the fourth quarter 2016 compared to the fourth quarter of same year.

And on page number 6, we demonstrate how the new network launched in May 2016 was responsible for the major portion of our quarter operating margin increase. Our new network has refocused on the higher unit (7:25) portion. This flexibility permits us to happily take advantage of and adjust to market opportunities in accordance with seasonality.

Increasing our supply in certain high season months is part of our plan. However, challenging the recent environment, I would like to emphasize that it is due to the smart teamwork (7:51) of our dedicated aviation professions that GOL was able to minimize the effects of the crisis on our operation. Our single fleet type (8:02) operations and fast turnaround times helped us to partially mitigate the adverse conditions. The result of our operational excellence is reflected in our monthly punctuality data.

Moving to the slide number 7, we had maintained load factors near 80%. In December, we saw load factors and yields improve which has helped us exceed our guidance for the fourth quarter.

Moving to page number 8, as you can see, even with a 15% in the number of aircraft in the fleet, net revenues increased 0.5% quarter-over-quarter and reached BRL 2.7 billion. Q4 revenues increased 11% over third quarter 2016. Among the factors that drove fares higher in the quarter where a 19% increase in average fare, a 16% higher stage length and a 4% higher yields combined with 7% higher RASK.

On slide 9, you can see a key reason for our RASK improvement is our significant investment in the customer experience, which now includes onboard Wi-Fi that we launched in Q4. By the end of this year, we're going to achieve 78 aircraft equipped with such feature.

Moving to page number 10; looking at the first quarter of 2017, while we expect the industry environment to remain difficult in the short term, GOL is seeing strong underlying demand for our service as daily ticket sales have increased around 30% in January as compared to December figures. And we are experiencing load factors above 80%. Aircraft utilization is increasing 10%.

Moving to slide number 11, since the launch of our new flight network, we increased our load factors by an average of 2 percentage points in the second half of 2016. And our forward bookings are strong. For the first six months of 2017, we expect loads to be in the high 70s.

Moving to page 12, I present the last six years of operating profits that represent the combination of our capacity reductions, network reorganization, cost discipline, and stronger Brazilian real. Our low costs are a key differentiator and our growth in ancillary revenues and Smiles has contributed to our improved RASK.

On slide number 13, in summary, I'd like to emphasize that GOL is working smarter to strengthen our foundation so as deliver consistent and sustainable results for our shareholders through the business cycle.

On page 14, we highlight our 2017 focus areas. We are working on maturing our new flight network to maintain its contribution to increasing margins, keeping our dominant position in the Rio de Janeiro market; enhancing our connectivity and capillarity in Galleon, Guarulhos and Brasília; developing new markets in the north and northeast of Brazil; investing in international regional expansion in South America and the Caribbean; increasing RASK from investments in customer experience.

Moving to slide number 15, for 2017, we are expecting increased aircraft utilization from our Boeing 737 aircraft. We will make seasonal capacity adjustments in Brasília by season (11:55) derived from our single fleet-type advantage. Our tactical capacity adjustments help us meet demand in different market conditions.

Our 2017 revenue metrics will be driven by the improved environment and deriving from the more stable Brazilian economy and currency. First, we expect to push our load factors higher. The key will be our continued focus on improving our execution across the commercial function.

In terms of outlook, we remain very cautious. There are six weeks of the quarter left to go and Brazilian Carnival is in the last week of February. We will carry over 8 million passengers in the first quarter this year. And the full year ex-fuel unit costs should increase by approximately 1%.

Looking now to – out into 2017, it seems clear that pricing will continue to be challenging as Azul and Avianca are adding capacity in the Brazilian domestic market. We intend to respond to those adverse market conditions with, unlike other airlines, even lower unit costs, we believe that will result in the best outcome for our passengers, our employees and our shareholders.

Before handing (13:23) the call over to Richard, I would like to review some of our competitive benchmarks. On page 16, you can see we are among the top airlines in revenue generation per aircraft, primarily due to our productivity and high load factors. Also, if the real maintains its appreciation trend compared to the dollar, these figures could be even better next quarter.

The graph in the middle compares stage-length adjusted CASK. GOL is second to only Ryanair. GOL has the lowest CASK in the Latin America region and in Brazil. We expect more in terms of CASK reduction for the near future. We have already concluded in 2016 our investment in technology and product and we'll begin to receive the first five Boeing 737-800 MAX in July next year. This new equipment will enable an increased range combined with lower fuel consumption.

On the right graph, you can see a comparison for total operating cost over total net operating revenue ratio. The current 93% is too high and we are implementing a comprehensive cost reduction plan, intend to contribute with higher and sustainable operating margins within the next two years. Richard will also provide some extra color ahead.

Moving to slide 17. For the CASK, ex-fuel, adjusted by the average stage length, we can see GOL has one of the lowest fixed cost structures in the world, among the leading low-cost carriers. We have demonstrated our commitment to remain Brazil's lowest cost carrier since our foundation in 2001 and it's a continuous and relentless effort of the entire Team of Eagles which enable GOL a sustainable competitive advantage over the other airlines in the region.

Since we have a standardized single fleet, GOL obtains smaller crew cost and better spare parts management. Nevertheless, safety comes always first as we maintain our FAA certification as best-in-class maintenance.

We also have a lean and productive operation that position GOL as number one in the most important and efficient airports. As a result, we are able to extract the best aircraft utilization. We have reduced our exposure to fixed costs with an efficient administrative structure working towards improving our client experience and strengthening GOL's brand. In summary, through consistency, efficiency and service, we expect to deliver sustainability and profitable growth for our shareholders.

With that, I'm going to hand over now to Richard Lark who will take us briefly through the MD&A of the quarter. Richard.

Richard Freeman Lark {BIO 3484643 <GO>}

Thanks very much. Moving to slide number 18, we had a solid December quarter while maintaining the lowest cost in Brazil and our number one position in traffic. On page 18, we have the quarter highlights. We attained a 7.4% operating margin. This figure included approximately BRL 142 million in restructuring costs, which were non-operating expenses.

From 144 aircraft in December of 2015, during the year 2016, we reduced our fleet to 121 aircraft at the end of December 2016 and our plan contemplates an average fleet of 115 aircraft in 2017. The capacity rationalization required by the industry's slowdown in recent years is finally paying off.

Despite a 3% decrease in RPKs year-over-year, our load factor reached 78%, 2.2 percentage points higher than the fourth quarter 2015. This was possible due to our concentration on capacity and yield management. In the fourth quarter, GOL's airline operations reduced capacity by 5.7% and increased passenger revenues per seat kilometer or PRASK by 6.8%, permitting a total RASK improvement of 6.6% in the quarter.

The 19 percentage point reduction in available seats above the 6.9% ASK reduction in the year is primarily due to the increase in stage length which is part of our new route network fully implemented in May 2016. GOL's continuous focus on improving revenue management helped drive a yield increase of 3.8% over the fourth quarter of 2015. From January to December of 2016, yield was up 8% and PRASK increased 8.5%.

The operating margin expansion in the quarter resulted in an EBIT of BRL 198 million. For the full year, operating margin reached 7.1% with an EBIT of BRL 697 million. We remain the lowest cost provider in the region and we were able to obtain a significant reduction in leverage. At the end of this quarter, leverage was 5.7 times, while 12 months ago, it was 11 times. We had net losses of BRL 30 million in the fourth quarter of 2016 and net income of BRL 1.1 billion for the full year.

On slide 19, you see that the increase in profitability was driven by a 7% increase in RASK and a 5% reduction in CASK. Cost performance was very good. We had a 5% unit cost reduction in the quarter just ended. And when we strip out fuel, that was up 1%. We are targeting, as Paolo said, to keep unit costs, ex-fuel, stable for 2017.

At BRL 0.21, total operating cost per seat kilometer or CASK reduced 5% over the same quarter of 2015. This CASK, excluding fuel, increased 1% in the quarter-over-quarter comparison. Compared with the RASK increase, we captured an increase in the profit through operations of BRL 0.014, representing a significant improvement when compared to the same period in 2015.

In the quarter, consolidated CASK, ex-fuel, was BRL 0.152, an increase of 1.2% in the quarter-over-quarter comparison. The decrease in CASK was primarily driven by fuel price reduction, which in the quarter was BRL 1.94 per liter, representing a 12.7% decline when compared to the fourth quarter of 2015.

It is worth mentioning that GOL increased by 11.4% - GOL decreased by 11.4%. We had a reduction of almost 12% in the number of fuel liters consumed per RPK during 2016 versus three years ago as a result of the ongoing initiatives over the last several years to improve operating efficiency and reduce fuel consumption. As a consequence, higher RASK but lower CASK led GOL's EBITDAR margin to just under 17% in the quarter.

On slide 20, you see our net financial results. The results, BRL 31 million of financial income and BRL 194 million of financial expenses in the quarter.

Moving now to page 21. We've broken down our net income variation between the fourth quarters for you. Beginning from the left, GOL had BRL 89 million of additional revenues in the year, BRL 606 million of savings in fuel, BRL 61 million in lower commercial expenses, and BRL 197 million in other expenses savings.

BRL 76 million were salary increases to compensate for approximately 8% inflation in local currency. Exchange rate gains were responsible in the quarter-over-quarter comparison for a delta of BRL 3.7 billion in non-cash net financial results. This item explains the net income, primarily net income variation between the quarters and taxes explain the balance of BRL 585 million. This is explained by compensation of the cumulative losses in previous years.

GOL reported a loss of BRL 0.09 per share for the quarter and a profit of BRL 3.17 per share for the full year. On an ADS basis, with our ADR program, GOL reported approximately $0 per ADS for the quarter and earnings of $0.09 per ADS for the full year.

On page 22, you can see the breakdown of GOL's cash flow evolution from the third quarter of 2016 to the fourth quarter of 2016. GOL increased by BRL 79 million in cash and accounts receivable primarily due to operating activities and also entirely offset by investing in financial activities.

The balance sheet liquidity is shown on slide 23. We continue to work on delivering GOL's balance sheet with the objective of moving up to a B credit rate. We have BRL 1.9 billion in cash and cash equivalence.

On page 24, you can see we reduced our debt by a total of BRL 2.9 billion during 2016, and the breakdown, you can see also of our financial debt maturities.

Moving to slide 25, two-thirds of GOL's debt is asset-based and we've been successful in lowering GOL's cost of debt. And as you can see on slide 26, our net leverage, including off balance sheet aircraft leases finished the quarter at 5.7 times, which was a significant improvement from 11 times at the end of 2015.

On slide 27, I want to take a few minutes to review the relative performance in liquidity of GOL's shares in the market. During the fourth quarter of 2016 and right up until February 15 of 2017, GOL surpassed all of the XLA index, which is the airline index, also the Tier 1 LCCs comprised of Ryanair, Southwest, JetBlue, and WestJet; and the IBOVESPA, the

Brazilian Stock Market index, by 6 percentage points, 11 percentage points and 8 percentage points respectively, as you can see on this page here.

Gross average trading volume per day was $3.5 million on the NYSE and BRL 19 million per day on the BM&FBOVESPA in the same period. One of the challenges we have had recently in our public market trading value has been the relative lack of liquidity in the ADSs. And for this reason, the board has agreed to alter the ADR ratio of PNs to ADSs from 10:1, previously to 5:1, which will be effected over the next few months.

Now, page 28 shows a table with some KPIs of benchmarks using the last 12 months ended December 31, 2016. From an operating margin point of view, we can see that despite GOL's situation, we have significant improvements and opportunities in comparison with low-cost carriers. But in spite of that, we lead the pack in margin in the South American market.

On slide 29, you can see a comparison of the profitability and the returns from these same airlines on the previous slide. Our fleet plan can be seen on slide number 30. We ended the fourth quarter 2016 with 121 aircraft in operation and we are at 120 now. In 2017, we will maintain an average fleet size of 115 aircraft, and in 2018, we will resume fleet growth and begin our aircraft replacement with the delivery of our first five Boeing 737 MAX 8 aircraft.

As you can see on page 31, we have significant flexibility to match our capacity growth with GDP growth. A key component of our fleet plan is the Boeing 737 MAX 8, as you can see on page 32. The MAX delivers more seats per aircraft, increased operating range, and improved performance, and significant cost reductions. As you can see on see on page 33, we expect an approximate 10% reduction in operating cost.

Our outlook is on slide 34. I hope it will be a favorable fare environment in the second quarter of 2017 with only 2% decline or less in capacity, but we don't have a clue as to what competitors will do, nor do we know what the outcome is going to be at this point for the second quarter.

For 2017 full year, we are assuming a yield increase to 6%, but that's a guess. We hope it will be more than that. While the environment can continue to be positive, if there's not capacity discipline, we could see pressure on yields.

We're planning for rise in cost in 2017 due to higher jet fuel prices. Our goal is to improve the trend of rising unit revenues in 2017 and achieve positive unit revenue comparisons for the year as compared to 2016. For this, we'll rely on effective revenue management and our route design techniques to achieve this, and we're leaning heavily on our fleet modernization to help mitigate unit cost pressures.

We expect better profits, cash flow and returns in 2017 despite the competitive environment. Our priorities for the balance sheet this year are unchanged. We'll continue to focus on the basics, running a highly reliable operation, offering our customers exceptional service and delivering results for our employees and our shareholders.

The guidance for 2017 is small decline in capacity of 2% or less; average load factor from 77% to 79%; CASK ex-fuel of BRL 0.14; EBITDA margin from 11% to 13%; and an EBIT margin of 6% to 8%. Downside risks are Q4 fares, external shocks and capacity growth.

With this, I thank you all for your attention and we're ready to move to the question-and-answer session for today's call. Please confirm your name and then ask the question.

Q&A

Operator

And our first question comes from Duane Pfennigwerth from Evercore ISI. Please go ahead with your question.

Q - Duane Pfennigwerth {BIO 7329167 <GO>}

Hi, thanks. I wonder if you could just kind of review for us what you're seeing in the corporate segment of your demand versus the leisure segment of your demand and where you saw more of a recovery in the fourth quarter and how those trends look here into the first part of 2017.

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

Hi, Duane. It's Kakinoff here. Thank you very much for the question. Actually what we have seen is that the total size of the corporate market has not increased. It's not recovered yet, (29:47) GOL has been able to achieve a higher market last year. For the first time ever, we took the largest portion in revenues. So, we were leading the market in the number of tickets sold to the business travelers. And in 2016, we achieved the market leadership in revenue.

So, it means that it has been able to bring more customers to fly GOL preferring the company. This is probably the results of the investment that we have done, changing the (30:22) more legroom, special packages conditions (30:28) now the Wi-Fi. So, I believe that the company will deliver continuously better results in that segment, but this is because we have been able to bring customers to fly GOL. It's not because the market size in that specific segment has increased, at least not until this moment.

Let's see now, because we are at the end of leisure – closer to the end of the leisure season. And after the Carnival, normally we have an increase in that segment. But it's quite soon to say that it's going to happen this year.

Q - Duane Pfennigwerth {BIO 7329167 <GO>}

And can you give us any sense high level – so it sounds like you're seeing a stable corporate market and your maybe your market share is increasing within that. But can you give us a sense for the recovery potential? How meaningful could a recovery in corporate be? How far below trend, may be a normalized trend do you think corporate activity is in Brazil?

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

Considering that the average fares in that specific segment are between 3 times to 5 times higher than the usual ones, any slight improve has a quite significant impact in the results. Personally, I believe that following the market expectations, the second half of this year would deliver a better economy dynamic in the country. And certainly, getting that effect, we would see an improve in the business travelers demand. So this is what we have expected. That's part of our plan. So, it could not happen in the second quarter and we are, I'll say, prepared considering our offer, our revenue management strategy and the network design, to only get access to a bigger business travelers market in the second half of this year.

Q - Duane Pfennigwerth {BIO 7329167 <GO>}

That's great. And then just my last one for Rich, the cost guidance that you've given us here, is there any sort of idle aircraft ownership embedded in that, that might be kind of non-recurring into 2018 and beyond? And thanks for taking the questions.

A - Richard Freeman Lark {BIO 3484643 <GO>}

Yeah. Thanks, Duane. Yeah. We have a couple of things. We have a couple of aircrafts that are in maintenance and the Wi-Fi upgrades while they're on our fleet. And so (33:08) it's 5 or 6 that are kind of going through that process of heavy maintenance in Wi-Fi through – pretty much now through July, August. And as we kind of articulated in our fleet plan, we can bring them in as demand season out and wraps up kind of in the September-October period.

We also have a couple of aircraft in subleasing in Europe, which are obviously not incurring costs on your question, but also give us the flexibility on the capacity side. But we expect that the inefficiency on the cost side should kind of go out of the system more or less in July as we go back to just to having a couple of aircrafts in the spare and maintenance capacity, and were moving along with the program on the Wi-Fi retrofit, but for Q2, it's about four to five average aircraft that are in the lease expenses but are not producing revenues.

We also decided a specific strategy to deal with the lower seasonality in the second quarter that is natural in Brazil on the demand side, plus try to make sure that we keep our capacity and overall (34:33) capacity in check, as we've got a couple of competitors that are, in Q2, thinking about bringing some aircraft into the market, which concerns us in terms of its potential overall effect on fares. So, we're trying to do our part to match demand with supply. And so long answer short, it's about four or five average aircraft in Q2 that in the July-August period will kind of come back online in terms of producing revenues.

Q - Duane Pfennigwerth {BIO 7329167 <GO>}

Thank you very much.

Operator

Our next question comes from Victor Mizusaki from Bradesco BBI. Please go ahead with your question.

Q - Victor Mizusaki {BIO 4087162 <GO>}

Hi. Good afternoon. I have two questions here. The first one, you reported adjusted net debt-to-EBITDA of 5.7 times and you also mentioned that for this year, I mean for the first quarter, you likely will deliver another seven aircraft. And I don't know if you can give us a guidance in terms of what do you expect in terms of financial leverage for this year?

And the second question, just to follow up about leisure and business travelers, I don't know if you can give us some color? I mean, you're not doing or making a lot of changes in your network. If you can give us a kind of breakdown in terms of leisure and business passengers for this new route?

A - Richard Freeman Lark {BIO 3484643 <GO>}

Yeah. Sure, Victor. Good afternoon. Our overall target for this 2017 is to get close to the 4 times range. I don't think we're going to get under that. But pro forma for the aircraft that are being delivered - redelivered here in the first quarter, they're already grounded or in the U.S. in the desert during the return process, pro forma for that leverage which goes out of the system were already with our EBITDAR assumptions. We're already at a leverage of about 4.5 times. That's because the market convention of taking seven times the operating leases inflates the overall leverage of those seven aircraft that are still going out of the system.

At some point between Q1 and Q2, we'll be at around 4.5 times on an accounting basis, but overall objective this year is to get to a 4 times level. As I mentioned as well, that we'll also be working to re-achieve a B status.

Now, on your question on the corporate versus - I guess I'll let Kakinoff follow up to the Duane's question on that.

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

Hi, Victor. Actually, it has been quite hard to predict when - as mentioned to Duane, predict when the business travelers, the size of them, that specific segment will be bigger than it is today. As said, we do expect to have more meaningful improvement by the second half of this year.

But the most important thing is that, after the redesigned network, GOL has further strengthened its strategic position among the top eight airports in Brazil, those are standing for 75% of the Brazilian GDP. So, I mean, those are the most important airports to the business travelers. Our market share among these airports is hanging from 35% to 52%. I believe nobody can come even closer to the offer that we have structured to this segment of customers in Brazil.

I mean, we strongly believe that we have an unbeatable network and a timetable to get in further preference of this customers. So, I mean, it's promising, but we do need to find a Brazilian better economic conditions which is supposed to happen from July on.

Q - Victor Mizusaki {BIO 4087162 <GO>}

Okay. Thank you.

Operator

Our next question comes from Savi Syth from Raymond James. Please go ahead with your question.

Q - Savanthi N. Syth {BIO 17476219 <GO>}

Hey. Good afternoon, guys. Just first off on the 2017 outlook. It's right in line with what we're thinking. But if I look at the 1Q outlook, I'm a little bit confused about the components. The yield guidance of BRL 0.24 is below 4Q 2016 and below 1Q 2016, which seems at odd with your comments on January trends. I was wondering if you could talk a little bit about that.

And then also just on the ex-fuel unit cost, it's about 3% year-over-year if you exclude the gain on sales and you do have a nice tailwind in FX. I'm wondering is that because of the, Rich, what you mentioned about the aircraft that's still non-producing and then maybe some of the cost related to that?

A - Richard Freeman Lark {BIO 3484643 <GO>}

Yeah. Sure. Yeah, on the revenue, yes. I mean we have – that will depend on the March, as we mentioned we have the Carnival at the end of next week, the first week of Brazil is – first week of March is a holiday week. So doing better than what we – what I mentioned there will depend on March.

January is very good. January is very strong. So based on January, if those trends continue through March, we will do better than that. But we're being conservative because of the competitive capacity dynamic. And as you know, any change on yield can have an extremely big impact on profitability.

On the cost side, yes, we are. In our planning for 2017, we were assuming in October of last year based on our own macro economic projections BRL 3, but it was more at the end of the third quarter. We're already getting close to that level. So, yes, and fuel or let's say oil prices has not tracked that as it normally would with a pretty close to minus 1 correlation. So, we do have year-over-year of fuel cost increase, but the exchange rate effect is more than overwhelming that at this point in time kind of temporarily, if you will, in January. So, you know what, it helps a bit in January. We expect to give a little bit of that back on the fuel side kind of going through March.

But there is a potential for us to do slightly better than that on the non-fuel cost side because of the exchange rate effect, and then kind of going back to the extent we can maintain discipline or rationality on yields in terms of all the competitors in the market, we could retain some of that in the operating margin. But it's still – we have good visibility on the bookings, but not 100% visibility on the yields and much less so in Q2. But the trends are positive for us to have better-than-expected yields based on where we stand right now.

Q - Savanthi N. Syth {BIO 17476219 <GO>}

Just to follow up on that, Rich, what's the pro forma rent going to be once everything is returned? What's the kind of the new level of rent expense?

A - Richard Freeman Lark {BIO 3484643 <GO>}

Rent expense per ASK or...

Q - Savanthi N. Syth {BIO 17476219 <GO>}

Or just after you return all the aircraft to the lessor.

A - Richard Freeman Lark {BIO 3484643 <GO>}

Yeah. I mean, it's – you're saying, like, what? On a monthly basis or quarterly basis or annual basis or?

Q - Savanthi N. Syth {BIO 17476219 <GO>}

Quarterly is fine.

A - Richard Freeman Lark {BIO 3484643 <GO>}

That goes down. It's about another BRL 7 million that comes out on a quarterly basis, BRL 7 million to BRL 8 million, that you would take out of those numbers.

Q - Savanthi N. Syth {BIO 17476219 <GO>}

Okay. That's helpful. And then, if I may, as you look out to kind of 2017, 2018, could you share a little bit more about what your CapEx expectations are and what you might want to do on the debt front?

A - Richard Freeman Lark {BIO 3484643 <GO>}

Sure. I mean, 2017, 2018 – 2017, we have – this year, we have approximately a little over BRL 1 billion in CapEx, the majority of 60%-70% is related to the engines and maintenance on those. We have a small portion of that which is the Wi-Fi upgrades here in progress in that BRL 1 billion.

The majority of it is covered with financing sources. So the cash portion of that CapEx is only around 20% of the total CapEx balance. That comes from low-cost financing sources such as we have with facilities we do with the Ex-Im Bank guarantee, facilities we do with

Delta and Air France maintenance – credit facilities. And so, the majority of that is covered through these mechanisms that we use.

CapEx, 2018 is a little bit down from that. And the PDP component, this year and next year will be – this is – the first five deliveries are already covered by sale leasebacks and it's possible that we'll have all of those 18 deliveries for the MAX also covered with sale leaseback. You saw this week we announced sale leasebacks for the first five of those on the MAX order so that the PDP component of the CapEx is expected to be much less also.

So we're pretty comfortable with the investment cash flows in terms of what we're doing there financially and financing loss. And then we'd start, in 2018, we would start to have – most likely have PDP as financing requirements as we start to take ownership of those portion of the MAX deliveries as they start to ramp up in 2019 on our plan, which will – we expect will be matching GDP growth at that point in time.

Q - Savanthi N. Syth {BIO 17476219 <GO>}

Helpful. All right. Thank you.

Operator

Our next question Petr from Barclays. Please go ahead with your question. And Petr has disconnected. Our next question comes from Matt Fallon from Deutsche Bank. Please go ahead with your question.

Q - Matthew Fallon {BIO 16763664 <GO>}

Hey guys. Thanks for taking my question. So, aircraft rent came down substantially in Q4. Why is it down so much? What drove the decline? And what's the go-forward number?

A - Richard Freeman Lark {BIO 3484643 <GO>}

Yeah. Well, I mean, if you – as we described in the press release, it's mainly due to the impact of contract re-negotiations throughout 2016. GOL, we did a major fleet restructuring in 2016. I mean, when all is said and done, it's 25 – over 25 aircraft that are returned. In the context of that massive unprecedented fleet reduction, we were able to re-negotiate and have improved productivity on that.

There's also an exchange rate effect in there as well. If you look at the full year, there's an impact of the average – the depreciation of the real against the U.S. dollar which is around 5%. And there's also an effect which relates to the time lag between removing an aircraft from operation until its actual return. As we were mentioning, we have an inefficiency there where we're still paying the rent on some of those aircraft.

And so if that was fully pro forma, that number would have been much lower. But it's primarily due to the work that our fleet team and the management team did on restructuring the fleet, specifically on the aircraft rent side and – but keep in mind also that the network restructuring that Kakinoff mentioned in his piece of the call is also very important for us improving productivity. The allocation of those ASKs and improving productivity, so there's a – there's also a general component in that across our base of what management was able to do to better allocate the assets on the root network. So, it's a combination of those factors. But the main factor was the impact of contract renegotiations that happened throughout the year as GOL affected this massive fleet restructuring.

Q - Matthew Fallon {BIO 16763664 <GO>}

Great. Thanks, guys.

Operator

Our next question comes from Lucas Barbosa form UBS. Please go ahead with your question.

Q - Lucas Barbosa {BIO 20412168 <GO>}

Good afternoon, Kakinoff and Richard, this is Lucas from UBS. Thanks for taking my question. Congratulations for the results. My question is just a follow up on the last question. Is that BRL 120 million aircraft rental costs seen in this quarter a recurring level going forward or was there any one-off in this line? Thank you.

A - Richard Freeman Lark {BIO 3484643 <GO>}

Yeah, as we described, we have, in the quarter, we had around a little over BRL 140 million in a variety of issues in there. Primarily in the non-operating expenses. So when you look at the total CASK, it's important to remember that we had around BRL 140 million in the quarter that was related to the – when we return aircraft adjustments and maintenance in a variety of costs that we have to be able to return those aircraft.

But within the actual leasing number – I'm just checking here for you, Lucas. I think with the actual leasing number that we had or – and that number that you're thinking there is about BRL 8 million to BRL 10 million of one-time costs that were recorded in the aircraft rent line that specifically relate to that. The majority of the others were – there was a bit of maintenance and then the rest is in the other operating expenses.

Q - Lucas Barbosa {BIO 20412168 <GO>}

Okay. Thank you.

Operator

Our next question again comes from Petr from Barclays. Please go ahead with your question.

Q - Petr Grishchenko {BIO 19084897 <GO>}

Hi, guys. Thanks a lot for taking my questions. Sorry. My phone dropped before. I don't know if someone asked, but I was wondering if you can talk a little more about the nature of the sale leaseback agreement you guys announced just recently in terms of capital or operating lease, and if you can give us some more color on that kind of implied cost of financing and the timing of net proceeds.

A - Richard Freeman Lark {BIO 3484643 <GO>}

Well, yeah. I mean, those are timed for deliveries which start in the middle of next year, so the actual transactions happen according to the delivery schedule. We can't provide the specific details on the negotiations we do with the lessors. But we have a very attractive price – very attractive asset, very attractive with Boeing.

And then as you know, with the sale leasebacks, it's a combination of the sale price plus the lease rate and we negotiate the best terms for our shareholders. We can't provide details on that other than to say, generally, the costs on these – I would say if you want to look at it, kind of it's like – our financing costs, it's kind of in the 4% range on the financing costs in terms of kind of what is the effective financing cost in dollars is for our – we generally on our dollar assets which are the aircraft, we're generally kind of in the 3% to 4.5% range on our – on the effective financing cost that go on to the leasing, which mostly we've been doing (51:29) do an Ex-Im type financing.

Q - Petr Grishchenko {BIO 19084897 <GO>}

Got it. Yeah. That's very helpful. Thank you. Another question I had, assuming full-year 2016 results, can you perhaps update on the EBITDA sensitivity to the move in BRL?

A - Richard Freeman Lark {BIO 3484643 <GO>}

I mean, yes. Obviously, we have an environment, I think, going forward where we're looking at – we're working with kind of – our forecast for the year was about 3.16%. The market, thus far, is kind of tracking ahead of that; so we don't expect a lot of sensitivity on the exchange rate in terms of volatility, but trying to answer that question as (52:17), you'd have to tell me what your assumption was on oil prices because for us, the two of them work together on our fuel costs and on our business because they indirectly affect the yields also.

And so, we don't really work with just on exchange rate in isolation on EBITDAR because it has a very high correlation to what happens on yields. And we also have to look at what's going to be the assumption on fuel. Thus far, we're getting a little bit better than expected on the fuel. We're doing a little bit better than our budget.

But in terms of the overall volatility for our business, it's very large. If you take the standard volatility for exchange rates and WTI or oil, if you will, and apply it on our cost structure within the actual volatility that exists in those commodity prices today, on an EBIT margin basis, you're a little over 10 point swing on the margin, kind of like plus or minus 5 points on either side of what our current situation is, assuming the current market volatility that exists for exchange rate and oil.

We really have like two ways of looking at it. What our expectation is which is a – we're working with a stable to slightly appreciating real and increasing oil prices. We expect oil prices to increase substantially from now to the end of the year. That's how kind of we're working with our budget and that's kind of what we've guided in our costs, kind of flat year-over-year ex-fuel costs, and then a significant increase in the fuel cost is what we're looking at our 2017 guidance.

But generically, if you were to kind of throw it on a – in a matrix, you kind of go up 5 points and down 5 points around that using the current market volatilities. I don't know if that's helpful. But I think you also have to have a – you have to have a view on the oil prices because they work together with us. An isolated movement in the exchange rate, while it can have a short-term effect over three or four months, you also have to look at what's going to be happening with the oil prices and then see how that's going to affect our fuel price and our cost structure and then how that flows into yields because yields in the Brazilian market also are highly correlated with what goes on, what happens with the exchange rates and fuel.

So in terms of how we get to the overall margin, we don't necessarily look at it as an isolated impact of what exchange rate would do in isolation or what fuel would do in isolation. We have to look at kind of the overall package. But I think what we can do is, going forward, we can think about how to help folks think about that – those volatility issues which are significant for our business as we think about how we provide guidance and talk to the market. I'll take that to heart and think about it.

Q - Petr Grishchenko {BIO 19084897 <GO>}

Great. Thanks a lot for the color. And the last thing from (55:18), do you have any maybe additional color on – from industry perspective for the bill (55:27) airline ownership could mean for the industry. And I don't know if you'd talked to that before, but is this potentially going to encompass just the passenger and transportation or also cargos and logistics? Any discussion would be helpful.

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

Hi, Petr. Kakinoff here. And this is just to – I mean, I repeat the statement that GOL has delivered to the market since the beginning. The company is totally in favor of liberalization in every sense. So, it doesn't mean that we have restrictions to get access to capital due to a quite ancient legislation. This is not related to speculations regarding selling any stake of the company or having another strategic investors increasing dramatically its position. Or this is – as I said, this is basically speculation.

What we have always mentioned is that the capital structure of the company would be much simpler and then highly appreciated by the investors without having the structure of voting shares, no voting shares, the ratio (56:40) between them which has been necessary at the moment, exactly to get access to a bigger market. So, we are pretty much in favor of this liberalization. I believe this can be only positive.

And the other speculations regarding the possibility of having more competitors playing here in Brazil. I would say they are welcome. If brand does need the protection of such type of this relation to be feasible in the market, probably there is another problem. I believe that GOL is prepared to compete in Brazil with any kind of airline, even newcomers. So, I think this is the right decision to be taken. I cannot speculate on the political environment to approve it or not. But I think that the reasonable decision would be to have that thing approved and this is, I believe, our expectation at the moment.

Q - Petr Grishchenko {BIO 19084897 <GO>}

Got it. Yes. Thanks a lot. Thanks a lot for your answers and best of luck in 2017.

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

Thank you.

A - Richard Freeman Lark {BIO 3484643 <GO>}

Thanks, Petr.

Operator

Our next question comes from Pablo Zaldivar from GBM. Please go ahead with your question.

Q - Pablo Zaldivar {BIO 20206792 <GO>}

Good evening. So we had witnessed during the quarter a drop in leases per aircraft. I believe it should be because of your renegotiation – to open the (58:27) renegotiation of your contract. I was wondering this should be sustainable going forward?

A - Richard Freeman Lark {BIO 3484643 <GO>}

If you're talking about the cost per ASK, yes that's a sustainable number going forward. We have this very large fleet reduction, which removed all the excess capacity from our system. We have a little bit of inefficiency in Q1 because we're still returning aircraft from that negotiation and then in Q2 in the seasonality, we keep some aircraft in maintenance and upgrades on the Wi-Fi. And so we also continue to show some lower productivity on that aircraft front per ASK in Q2. Then, in the second half, we should see improvements in that. So it's always (59:18) sustainable, we expect.

And as Kakinoff mentioned as well, we're also working to improve our aircraft utilization, which means we're producing more ASKs per aircraft, so the denominator of that goes down. And our aircraft – our Boeing 737 aircraft have the ability to increase utilization above the current levels.

Thus far this year, we're kind of tracking with the 10% increase in utilization. So in the first half that compensates some of this inefficiency we mentioned on having aircraft out of service. But we should see significant competitive gains for us on that in the second half as our Boeing 737s crank up the aircraft utilization, which is an important thing to understand about our business, especially us as the only 737 operator in Brazil.

Last year – really kind of over the last may be two years, we were not able to fully take advantage of the utilization capability of the Boeing just given the economic stagnation in Brazil. But here going forward, we are working on going back to using that capability which, for this year, somewhere between a half hour to 50 minutes higher aircraft utilization, which is significant. But the way (1:00:45) you can think about that is effectively each aircraft is doing an additional flight per day on the existing asset. So we're having a much bigger dilution of fixed cost.

And what – as Kakinoff mentioned as well on the chart he showed you showing the fixed costs versus the variable costs, in our business, we have a very high operating leverage based on the low fixed cost component of our business, which is the aircraft. So we can squeeze another half hour to an hour a day out of those aircraft is significant in terms of the overall profitability. So it's always (1:01:20) sustainable we're going to push that cost advantage further this year.

Q - Pablo Zaldivar {BIO 20206792 <GO>}

Okay. Thank you.

Operator

Our next question comes from Julia Bretz (1:01:36) from BCP Securities. Please go ahead with your question.

Hi. Thank you for taking my question. I know you mentioned a little bit about this leaseback agreement. So if you could give some numbers, I don't know if you could, but for the market value of the 737s? And then, if GOL has made any down payments for these?

A - Richard Freeman Lark {BIO 3484643 <GO>}

No, we don't – when we do the sale leasebacks, they're one of the (1:02:03) confidential transactions we do with the lessors and so we can't provide information on that. But in our particular case, we – and these were the down payments that we would normally have on an acquired aircraft, the PDP payments. We then are not making those in the context of the sale leaseback transaction. They are then put into the deal where basically the lessor is picking that up, so that goes out of our CapEx plan.

The Boeing 737, in general, has a very, very high value in the market and so we monetize that in the negotiation with lessors in a combination of purchase price plus the lease rate. But it's a combination of what we want on the cost side on an ongoing basis and what we get in terms of cash. But those would – this deal is already done, but as these aircraft are delivered next year, we'll probably be able to see some details on that next year as we – we're about one year ahead of the curve on our delivery. So we could probably provide some more information on that next year.

Q - Operator

Okay. Perfect. Thanks. And if I could ask one more question. Your taxes were also very high this quarter and if you could explain the reason for that and then give a little guidance for this year as well?

A - Richard Freeman Lark {BIO 3484643 <GO>}

We - GOL is a - on the airline side, we're not paying any taxes because of our net operating loss carry-forwards and we have a very large amount of tax credits, net-net operating losses, which have an unlimited term which we amortize against any income we have.

The other effect you're seeing there is the effect of the income tax on Smiles, which is a subsidiary of our holding company which we consolidate. And so what you're seeing there is also the effect of the - and Smiles is a full taxpaying entity, very profitable and full taxpaying entity with the majority of the numbers on the income tax are coming from - the income tax expense is from the Smiles subsidiary.

Q - Operator

Right. So will these expenses continue during this year for Smiles?

A - Richard Freeman Lark {BIO 3484643 <GO>}

Yes, they will because Smiles is growing there. You can find some information on them on their website but they're growing at a very nice rating, continue to increase their margins and so they will be continuing to increase that tax amount on a relative basis. In terms of the overall consolidated numbers on our side, it probably shows a slight increase just because our overall business is six, seven times the size of the - the airline is six to seven times the size of the overall Smiles business in terms of revenue. So it dwarfs that in our overall revenue and tax calculation.

But I think the important thing to think (1:05:04) about GOL going forward is as GOL - as we go back to January (1:05:10) generating operating profitability and pre-tax profitability, we have a very efficient tax planning to minimize those as we grow earnings on the airline side of the business.

On the loyalty (1:05:27) side of the business, they will basically continue to show those level of taxes going forward, growing more or less with the size of their business which is kind of growing in the 20% per year range.

Q - Operator

Okay. Thank you very much.

Our next question comes from Paul Lukaszewski from Aberdeen. Please go ahead with your question.

Q - Paul Lukaszewski {BIO 17231300 <GO>}

Hi. Maybe if I could just start with sort of cleaning up and clarifying a few things you've gone through up till now. I believe you said you're expecting CapEx of about BRL 1 billion in 2017. Did I hear that right?

A - Richard Freeman Lark {BIO 3484643 <GO>}

Correct. Yes.

Q - Paul Lukaszewski {BIO 17231300 <GO>}

Okay. So can I clarify, does that include PDP or PDP is on top of that BRL 1 billion?

A - Richard Freeman Lark {BIO 3484643 <GO>}

We don't have any PDPs this year as it relates to our MAX delivery because of the sale leaseback transactions we've done. The first five incorporate those PDPs so that we don't have any PDP outlays this year. We might have some next year depending on what we do with the 2019 delivery.

Q - Paul Lukaszewski {BIO 17231300 <GO>}

Okay. All right. So that actually addressed my second question, which was whether that schedule detailing the PDPs reflected the sale leaseback transaction from earlier this week and it sounds like it did not. So those PDPs have gone away. Is there...

A - Richard Freeman Lark {BIO 3484643 <GO>}

Yeah. Right. Okay.

Q - Paul Lukaszewski {BIO 17231300 <GO>}

So then I guess the follow up to that, is there any sort of netback of any PDPs that you would (1:06:57) have recovered back as a result of the sale leaseback against the BRL 1 billion or is that already factored in?

A - Richard Freeman Lark {BIO 3484643 <GO>}

That's already factored in because also – as part of our restructuring plan last year, we did a complete restructuring of our PDP deposits. And so, going forward, we'll only have outlays to the extent we actually are going to be financing and taking ownership of the aircraft. Like I said, in 2018, we might have some PDP outlays based on (1:07:24) that's two years down the road. We're kind of working one year ahead at this point on the MAX order.

Q - Paul Lukaszewski {BIO 17231300 <GO>}

Okay. Okay. Thanks for that. Moving on, sorry – and apologies for having to do this, but back to the rent expense line, just to make sure I've kind of got it completely. Are your comments that the sort of BRL 8 million to BRL 10 million of noise in the quarterly run rate of what was about 120. So assuming steady state dollar, we're sort of talking about a sort of 110-ish aircraft rental line per quarter going forward. Is that a number we can work with?

A - Richard Freeman Lark {BIO 3484643 <GO>}

Yeah. I mean, part of it – on the absolute dollars, on the absolute reals, I'll take a note and get back to you on that, provide you more on that. But more or less, along those lines, yes, I mean that's the number on ASK basis. We had a lot of – there was a lot of noise throughout the year on a quarter-to-quarter basis. There's still a little bit of noise in there in Q4 that I guess is (1:08:34) guys a bit, but it's – that's more or less what we're expecting on an ASK basis going forward. As I said, it probably improves a little bit on an ASK basis based on our lower – our plans on increasing productivity but the (1:08:49)...

Q - Paul Lukaszewski {BIO 17231300 <GO>}

Okay. I guess, so it's a fair conclusion to draw that more of the fleet restructuring was concentrated in the operating leases than the financial leases, just kind of given the degree of magnitude in terms of the reduction of aircraft rent in the P&L?

A - Richard Freeman Lark {BIO 3484643 <GO>}

Yeah, I guess, you could say that. I mean, it's (1:09:11) across the broad. I mean, today, we have 31 aircraft in a finance lease construct going forward. (1:09:23) because two years from now, as you know, we're going to have an accounting change which all leases, including operating leases, will be treated as finance leases, so they have got cleared up. They will go entirely out of the operating margin and move into the construct of interest expense and depreciation. But, yeah, I think it's fair to account (1:09:42).

Q - Paul Lukaszewski {BIO 17231300 <GO>}

Okay. And one more on this aircraft front. I believe your prior guidance was that the fleet size would come down, the full operating fleet, including the subleases and the aircraft waiting for return. I thought the target was that that was going to come down 122 versus us finishing at 130. Is that correct, or I've sort of mixed apples and oranges here?

A - Richard Freeman Lark {BIO 3484643 <GO>}

What period?

Q - Paul Lukaszewski {BIO 17231300 <GO>}

I thought in the third quarter, you guys guided to expect the year-end fleet number to 122 either after second quarter or after the third quarter. I thought that was the guidance. So, finishing at 130, I thought was a bit high.

A - Richard Freeman Lark {BIO 3484643 <GO>}

Yeah, we said we finished at 120 – talking about December 2016, we finished at 121.

Q - Paul Lukaszewski {BIO 17231300 <GO>}

Well, that's sort of the net number, right?

A - Richard Freeman Lark {BIO 3484643 <GO>}

Net number...

Q - Paul Lukaszewski {BIO 17231300 <GO>}

So the gross number including the aircraft to be returned and the aircraft on sublease is 130, no?

A - Richard Freeman Lark {BIO 3484643 <GO>}

No. No. The 121 includes the seven aircraft that are being returned. That'll take us down to - we'll hit kind of like April, May, we'll be at 115 aircraft. And that's - obviously that's net of the subleases, it doesn't include aircraft we have in subleasing. So that's not included in that number.

Q - Paul Lukaszewski {BIO 17231300 <GO>}

Okay. All right. Let me investigate where I got my number from then and if anything, I'll get back to you guys.

A - Richard Freeman Lark {BIO 3484643 <GO>}

Yeah, sure. I mean, the 130, I'm not - I mean 121 was the actual - today, we have 120. And like I said with the adjustments and so on, we plan this year to be at kind of 115, average. We're actually kind of - we'll hit that number kind of in April and that is an average calculation for the year, because we also have the subleased aircraft will be coming back in, in the Q3 - in the end of Q3.

So they also come back in, in the second half. (1:11:35) would allow us to take advantage of the increased seasonal demand in the Brazilian market and we have the flexibility on taking those aircraft back into the system either if you want to lease them and sublease those contracts expire in Q3. And so (1:11:51) important there is we have the ability to manage the capacity.

Q - Paul Lukaszewski {BIO 17231300 <GO>}

Okay. And my last question just where should we have our expectations for dividends going forward? Are you guys going to pay sort of the statutory minimum or how are you going to think about dividends in 2017?

A - Richard Freeman Lark {BIO 3484643 <GO>}

Yeah. So we won't be in a dividend paying position for years. You have to have a minimum reserve, if you - kind of like a minimum book value reserve. And we're working - (1:12:19) substantially in 2016, but we've got about a little under $1 billion of negative book value that would have to be recovered before - recapitalized, if you will, before shareholders could start to - GOL had paid dividends in the past when it got to a certain - but I think the key there is not - it's more - I mean 2017, no; 2018, no; I think 2019, 2020 perhaps is something, who knows? But the policy would be driven more by what the operating profitability of the business is because we have to be paying our operating costs, our capital expenditures, our debt service before we can get into a dynamic on return of capital to shareholders via dividends or stock buyback. So that's...

Q - Paul Lukaszewski {BIO 17231300 <GO>}

Okay. So the dividend line we see in the cash flow statement, that's another case of – is that – Smiles?

A - Richard Freeman Lark {BIO 3484643 <GO>}

It's interesting (01:13:19)

Q - Paul Lukaszewski {BIO 17231300 <GO>}

Is that sort of the net leakage of Smiles?

A - Richard Freeman Lark {BIO 3484643 <GO>}

Correct. Yes. The Smiles has a dividend and they are a cash-generating business, very high cash flow. And so, what you see there are the effects of the dividends that Smiles pays to shareholders and then you'd have the leakage out to the minority.

Q - Paul Lukaszewski {BIO 17231300 <GO>}

Okay. All right. Thanks very much. I appreciate it.

Operator

Our next question comes from Pablo Barroso from Credit Suisse. Please go ahead with your question.

Q - Felipe Vinagre {BIO 19282922 <GO>}

Hello. Good afternoon. Actually this is Felipe Vinagre. Just a quick question on the fleet restructuring. Just want to know how much did you spend in non-recurring fleet restructuring expenses in 2016? And how much do you expect in additional non-recurring expenses in 2017, with the additional reduction of up until 115 aircrafts? Thanks.

A - Richard Freeman Lark {BIO 3484643 <GO>}

Yeah. The whole fleet restructuring costs around BRL 220 million. And as you know, that was basically – from a cash flow perspective, that was financed with the operations we're doing with our old vintage – first vintage Boeing 737 aircraft. We did aircraft sales and sale leasebacks, which generated more than that cash amount which basically financed – internally financed the return of those aircraft. So going forward, we don't have any more expenses relating to that restructuring, that was all done with inside of 2016 and all the expenses are appropriately provisioned.

Q - Felipe Vinagre {BIO 19282922 <GO>}

Okay. So the additional aircraft that you are (01:15:08) already in the past, right? And the cash...

A - Richard Freeman Lark {BIO 3484643 <GO>}

Yes. When you return an aircraft, you may have some additional costs at the end. The inefficiency there relates more to the new owners or the new users of those aircraft picking up the aircraft. And so, to the extent (01:15:29) rents in there, which goes into the aircraft rent line as a – there's a number there. But it's really represented more by lack of revenue productivity as opposed to the one-time costs on those returns. But the actual return, the one-time cost which is reflected restructuring are already recorded in our costs.

And I highlighted those in the Q4, it was about a little over BRL 140 million that was provisioned and expensed in the fourth quarter related to the entire fleet restructuring format. But we might have some – we could have some additional costs to the extent that the aircraft deliveries delay, which is possible or there could be some additional costs, but nothing material but there could be some additional costs.

Q - Felipe Vinagre {BIO 19282922 <GO>}

Okay. Thanks. My last question. What's your breakeven margin for cash flow generation when we include, let's say, a more normalized level of CapEx to maintain the average rate of the fleet, et cetera? And also including in this math, the dividends paid to (01:16:42) minority shareholders decides the income taxes even when you don't have a profit. So all included, what's the breakeven cash flow – breakeven margin for cash flow generation? Thanks.

A - Richard Freeman Lark {BIO 3484643 <GO>}

Pre-CapEx, we're already above breakeven on operating cash flow. As we've highlighted for you, our CapEx in there, post-CapEx you have to add another 6 to 7 points on top of the current operating margin. If you want to be net cash flow zero on a margin basis, in our business, you need to be kind of around about 12% operating margin which is twice what the current level is.

All of our competitors have lower operating margins than us. So you highlight an interesting point, in terms of – and we look to be, as a business, net cash flow positive with what we're doing this year and next year in terms of revenue management, cost savings, reductions and what we're doing with the Smiles subsidiary in terms of the increase in net operating profits, and then hopefully improvement on the economic side which gives us some upside there. All of which can result in kind of a five- to- eight-percentage point over two- to- three-year period increase in our operating margin, assuming rationality on the competitive side.

But from an operating cash flow perspective, we're generating positive cash now, but we're not covering the CapEx, those are covered with financing mechanisms. But if you ask us, what would you (01:18:26) need to be zero net cash flow, it's a (01:18:30) point increase in the operating margin. But of course, all this is highly sensitive to exchange rate and your - your exchange rate and oil assumptions as well, which can go one way or the other depending on how you're going to work those two together, but assuming steady state with the numbers I just described to you.

Q - Felipe Vinagre {BIO 19282922 <GO>}

Thanks. Last question on the business demand potential. So last two years in Brazil (01:18:56) some big reductions on the demand from the business side, also from the government. You guys already seeing some recovery on that side, and how do you expect this to evolve in the next few months?

A - Richard Freeman Lark {BIO 3484643 <GO>}

In the first half of this year, we still have - still Brazil, economically, has done recovery. We expected that in the second half, depending what happens with the massive reduction in interest rates that's happening in the first half of the year as that could relate to economic stimulation, we could see better demand as Brazil business activity picks up.

You also have the U.S. dynamic, which is a big question mark to the extent that the U.S. embarks on the path of reindustrializing and improving its competitiveness. Brazil is a big, important factor in the supply chain for other industrialized economies. And our big corporate clients are the extractors, the natural resource companies, the construction companies, the real estate companies that have the same large amounts of employees around Brazil to develop Brazil.

The large chunk of our business, more than half of our clients are corporate clients engaged in industrial projects and so on around Brazil. So, that could have a big benefit. Our network is - we're the most corporate travel airline in Brazil with our network and so on. And you know how Brazil works with the large concentration of population centers along the coast and then the large location of natural resources and development is in the interior in the north and northeast.

And so, you have to use the airline transportation to transport your workers and your employees around the country. So to the extent that the developed - the biggest developing country in the world, the U.S. is reindustrializing this year and next, we expect that that will be a - have like a third and fourth derivative effect on our business on the corporate travel. But (01:21:00) right now, we don't have visibility on that. We have a partial visibility into the second quarter and that's it.

So, we're just speculating at this point on what might happen as a result of the reduction, the 300 to 400 basis point reduction in Brazilian interest rates and how that might get things going here in Brazil in the second half. And so, I think everybody is in that same boat in terms of what the second half of this year is going to look like macroeconomically. It has a different than 0% growth. We still don't know yet. We don't have that crystal ball.

Q - Felipe Vinagre {BIO 19282922 <GO>}

So, no rebound at this point, right, so just expectation on the benefits that (01:21:39)?

A - Richard Freeman Lark {BIO 3484643 <GO>}

We don't have visibility – when and how much of Brazilian economic recovery is going to happen, we don't have visibility on that.

Q - Felipe Vinagre {BIO 19282922 <GO>}

Okay. Thank you.

Operator

Our next question comes from (01:21:57) Please go ahead with your question.

Hi. Good evening. Thank you for taking my question. Richard or Kakinoff, I'd like to know if you're comfortable with your cash position, the liquidity to start off peak season? And if you are working somehow on the short-term debt, if you're trying to refinance talking with banks or if you are good with the level that you have right now?

A - Richard Freeman Lark {BIO 3484643 <GO>}

Hi. We don't have any significant short-term debt maturity this year within our construct on working capital. We're working hard there based on the constructs that we have with financing receivables and inventories. We have a small amortization payment on our 2007 issued bonds, which will be the first full amortization of a capital markets bond issued by GOL in April. That's a small outflow there.

But obviously, cash position in general with airlines, you never have enough cash. And so, we're very careful with our cash position. We're working hard to try to increase that. A lot of that would depend on stability and improvement and rationality and the capacity environment of Brazil, and also to some extent on the exchange rate. So, no, we're not comfortable with our cash balance. We need to improve it and work very hard, especially through the second quarter here in Brazil where we have downturn in terms of seasonality and puts a very high level of pressure on cash on all companies, but especially on airlines.

Q - Operator

Okay. Yeah. But do you have – can you give us forecast for the end of the year? What do you expect to have as a cash position?

A - Richard Freeman Lark {BIO 3484643 <GO>}

No, we're not providing that kind of information.

Q - Operator

And I just want to check few numbers. You expect net leverage to be at four times at the end of the year?

A - Richard Freeman Lark {BIO 3484643 <GO>}

No. I said we're working. We're working to achieve four times. I don't think we're going to achieve that this year. I think we'll achieve that in 2018. But I do think that once we've finished the return of all the aircraft that are going out through the system, we'll be at around 4.5 times on the leverage.

Q - Operator

And your forecast for the exchange rate is BRL 3.16 per dollar.

A - Richard Freeman Lark {BIO 3484643 <GO>}

Well, we're working this year and are planning in that range, BRL 3.16 to BRL 3.20, as an average for the year. I think, thus far if we were to stay at the current levels, we'd be a little bit ahead of that, but we'll have a lot of volatility in the currency. But that was our forecast back in October when we worked on our 2017 budget with that level. And so, I think we're more or less tracking on that, but we're very cognizant of the very high volatility, so we have to be careful.

Q - Operator

Yeah. Just one last question to clarify on the debt. You said you don't have significant cash that's maturing on short term, but are you working somehow with the banks? You have (01:25:20) maturing this year. And are you trying maybe with – to postpone this or rollover; or for the 2018 debt, are you already working with the banks or there's no need for that?

A - Richard Freeman Lark {BIO 3484643 <GO>}

Well, 2018 on the thing you mentioned, we most likely will roll over some of those things or refinance with other small activities we have facilities with, financing with maintenance and our Wi-Fi, with (01:25:50) guarantee and other things. I'd say, no significant – I mean, they're small relative to our overall capital structure, but we do have to work hard to manage them, and they're not insignificant in that respect.

But overall, our big debt maturities around in kind of 2020-2022 on our dollar liabilities. And then in 2018 and 2019, we have some larger maturities, as it relates to our Brazilian debentures. But yes, we will probably do some rollovers with some of these small debts or refinancing with the some of the small facilities we have inside of 2017.

Q - Operator

Okay. Thank you.

Ladies and gentlemen. This will conclude 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>}

Okay. Ladies and gentlemen, I hope you found our presentation and the Q&A session helpful. Our investor relations and corporate communications team is available to speak with you as needed. To finalize this presentation, we would like to leave you with GOL's competitive strength on page 35. We see clear and sustainable advantages over our competitors. We have the best gross benefit ratio for the passenger with a high rate of one-time performance and we are leader in the offering of flights at the main Brazilian airport, with young and modern fleet. So thank you very much.

Operator

Ladies and gentlemen, that will conclude today's conference call. We do thank you for attending. You may now disconnect your lines.