Q1 2018 Earnings Call

Company Participants

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

Other Participants

- Dan J. McKenzie, Analyst
- Duane Pfennigwerth, Analyst
- Joshua Milberg, Analyst
- Matthew Berland, Analyst
- Michael J. Linenberg, Analyst
- Petr Grishchenko, Analyst
- Rogério Araújo, Analyst
- Savanthi N. Syth, Analyst
- Soummo Mukherjee, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Welcome to the GOL Airlines First Quarter 2018 Results Conference Call. This call is being recorded and all participants will be in a listen-only mode during the company's presentation. After GOL's remarks, there will be a question-and-answer session. At that time, further instructions will be given.

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

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

At this time, I will hand you over to Paulo Kakinoff. Please go ahead.

Paulo Sergio Kakinoff {BIO 5160310 <GO>}

Thank you. Good morning, ladies and gentlemen, and welcome to GOL Airlines' first quarter 2018 conference call. I am Paulo Kakinoff, Chief Executive Officer, and I am joined by Richard Lark, our Chief Financial Officer.

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

Good morning.

Paulo Sergio Kakinoff {BIO 5160310 <GO>}

This morning, we released our first quarter figures. Also, we made available in GOL's Investor Relations website, three videos with our results presentation, financial review, and brief Q&A. We hope this allows you a better understanding of our quarterly results and give us much more time on this conference call for questions and answers.

We significantly improved all indicators in the first quarter 2018. GOL's RPKs increased by 4.5% from BRL 9.6 billion in first quarter 2017 to BRL 10 billion this quarter, mainly due to a 1.8% increase in the number of transported passengers. Strong demand allows GOL to continue driving revenue management. Average yield per passenger increased by 10.3% quarter-over-quarter, reaching BRL 0.2802.

Supply growth was measured with ASKs increasing 3.3% compared to first quarter 2017, driven by a 0.7% increase in take-offs and 3.6% stage-length expansion. As a result, the average load factor in this quarter grew 0.8 percentage points compared to the same period in 2017, reaching 80.4%. GOL remains the industry leader in on-time performance with 93.7% of flights on-time in the first quarter 2018 according to Infraero.

We continue to have strong revenue growth. The combination of higher demand and optimized pricing resulted in net revenue for the quarter of BRL 3 billion, an increase of 14.4% compared to the first quarter 2017. Net RASK was BRL 0.2387 in this quarter, an increase of 10.7% over same period 2017.

Net PRASK increased 11.5% quarter-over-quarter, reaching BRL 0.2253. Average fare increased by 13.1% from BRL 296 to BRL 335. GOL's 2018 guidance is for net revenues of approximately BRL 11 billion.

The GOL network serves higher yielding routes and has a leading share in the corporate client segment. We have the largest share of business traffic in the country. This year, we will begin incorporating the latest innovation 737 MAX 8 to our fleet, which will provide reduced operating expenses and expand the range of our network to allow us to cover all of Latin America, the Caribbean, and destinations in the southwest of the United States.

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

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

Thanks, Kaki. First, we'd like to comment about our controlled cost environment. Our total CASK in the first quarter of 2018 was BRL 0.198, which is 1.9% higher than the same period of 2017 in spite of a less benign fuel environment. On an ex-fuel basis, CASK fell by 4.8%. Excluding gains on aircraft sales in the quarter, CASK ex-fuel increased by 0.2%. And GOL remains the cost leader in South America for the 17th consecutive year.

Second, our margins continued to expand. While the average price of jet fuel increased by 7.4% in this quarter over the fourth quarter of 2017, combination of stronger pricing, higher demand, BRL 19 million of gains on fuel hedging and BRL 82 million of gains on aircraft sales, permitted GOL's EBIT margin to expand to 17% in the first quarter of 2018, which is the highest first quarter indicator since 2006, and a 7.1 percentage points improvement quarter-over-quarter. Operating income, EBIT, was BRL 504 million in this quarter, an increase of 97% compared to the same period in 2017. EBITDA margin was 22% in the first quarter of 2018, a growth of 8.1 percentage points quarter-over-quarter. EBITDAR margin was 30% in 1Q 2018, an increase of 6.7 percentage points in comparison to1Q 2017, and GOL's 2018 guidance is for an EBIT margin of approximately 11%.

And to finalize this brief review, we want to share the highlights of our balance sheet strengthening. Our net debt, excluding perpetual bonds, to LTM EBITDA was 2.5 times as of March 31, 2018, improving versus 3 times at the year-end and year ago metrics, which were 5.2 times. Total liquidity, including cash, financial investments, restricted cash and accounts receivable, totaled BRL 3.1 billion, an increase of 105% versus a year ago.

Combination of GOL's credit rating upgrades, tender offers and redemptions, and improved cash liquidity substantially increased the company's financial flexibility while decreasing its blended cost of debt and increasing the average maturity of the company's indebtedness.

On January 30, 2018, the GOL subsidiary, GOL Finance, priced an additional issue, a re-tap offering, in the amount of $150 million on its senior notes due 2025, with a coupon of 7% per year.

Regarding guidance, we expect 2018 to show continued improvement for GOL over 2017. Demonstrating our commitment to financial discipline in the face of the recent depreciation of the Brazilian currency, we plan to reduce our fleet by one aircraft this year versus our previous projection. Therefore, we reduced the projection of our 2018 average operating fleet from 118 aircraft to 117 aircraft. We expect to close 2018 with a 0 to 2% annual growth rate in domestic ASKs, a reduction of 1 percentage point versus the previous plan.

We projected an average load factor of 79% to 80%, and an ex-fuel CASK of around BRL 0.14. EBITDA and EBIT margins in 2018 are expected to be around 16% and 11%, respectively. We expect earnings per ADS to be between $0.50 and $0.65, down from our previous projection, reflecting the recent depreciation of the Brazilian currency.

Leverage, measured as net debt over EBITDA for 2018, should be close to 2.8 times, reflecting the deleveraging of our balance sheet. For 2019, we expect our domestic capacity growth to be between 1% and 3%, and non-fuel CASK to be around BRL 0.15. We also project an EBITDA margin of around 18%, and expect to end the year with leverage of approximately 2.5 times.

And with that, I'd like to return back over to Kakinoff.

Paulo Sergio Kakinoff {BIO 5160310 <GO>}

Thanks, Rich. We're delivering continuing improvement in our results, which we believe is proof that our strategy of offering a differentiated high-quality product while relentlessly focusing on cost efficiency is bearing fruit. We remain focused in offering the best experience in air transportation, providing punctual exclusive services to our customers on new modern aircraft that connect our main markets with the most convenient schedules.

Our entertainment platform is the most complete and modern in Latin America with live on-board television and on-demand Internet. The fleet has been retrofitted with eco-leather seats and on-board Wi-Fi. We also offer our customers, selfie check-in, GOL+Conforto seats, and expanded menu of onboard products, while maintaining low fare leadership.

In summary and to finalize, we had a very positive quarter, continuing on the strongly improving trend we have been showing over the past 21 months. We remain extremely focused on disciplined capacity and prudent management of our balance sheet and liquidity, maintaining our cost leadership and continuing as we further align for our customers while driving sustainable margins and returns for our shareholders.

To conclude, I would like to mention again that we made available on GOL's Investor Relations website, three videos with a results presentation, financial review, and brief Q&A, as well as the full presentation and the earnings release. We hope this will provide a better understanding of our quarterly results. In addition, this format will give us much more time on the conference call for the questions and answers section that we'll start at this moment.

Q&A

Operator

Thank you. The floor is now open for questions. The first question will come from Duane Pfennigwerth of Evercore ISI. Please go ahead.

Q - Duane Pfennigwerth {BIO 7329167 <GO>}

Hey. Thanks. So, I think the markets may be a little hyper focused on fuel and currency, but I wonder if you could just comment on, to the extent that those are inputs to your planning process, how your planning process has changed since the crisis. Looks like you took down your domestic capacity route and actually your fleet a little bit. But I wonder if you could talk a little bit about how those things are input into your planning process, and how that planning process has changed over the years. Thanks.

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

Yeah. Hi. Good morning, Duane. Our planning process, obviously, we went through a major restructuring of the asset side of the balance sheet end of 2015/2016. And we also built into our capacity, at that point in time, flexibility to vary the fleet up or down based on economic conditions. Basically, we have the ability to vary our fleet, our capacity, if you will, up or down by about 10% around that plan within a six- to nine-month period.

And so, that's our modus operandi. And so, with the – all we're doing is kind of applying this planning process which basically kind have three levels; it's capacity, making sure that (00:13:03) is rationally matched with demand; very optimized revenue management, taking advantage of our characteristics here in Brazil, which are a very high level of corporate travel, which gives us a high degree of pricing power. As you saw in the first quarter, we're able to get, we call it, a recapture of 100% of the net variation in oil prices and currency onto our fares and yields. And then finally, complementing that with hedging where needed on the leg that we need. And you saw the gains and the results of that additionally in the Q1. And so, we continue to apply that on a regular basis, and that's reflected in our slight tweaking of capacity for this year, which is updated there. And the only comment I would just say there is a couple of months ago, we were getting questions about more the conservatism of our guidance, meaning that we should be doing better than expected to what our guidance was, say, about three months ago from the sell side.

All I can say is that at that point in time, we were already incorporating a large portion of where we are on both oil prices and currency in our forecasts this year, as in Brazil with an election year. So, generally, about six months before an election, we get some increased volatility on the currency side. Obviously, that has been affected by the structural change in U.S. interest rates, which has really kind of been happening now since the end of January up until now.

But those numbers, those phenomena, both the (00:14:47) and election season here in Brazil, combined with the increases in interest rates, those are already incorporated in our guidance for the year. But as a result of the management tools we have, the real tools we have, which are capacity, revenue management and hedging, we're applying those, and those are reflected in our revised outlook for this year.

But I would say the only I would say additional comment I would make on that is that we more or less expected fuel to be where it is – sorry, oil prices to be where they are at these levels. Currency is probably around $0.15 to $0.20 higher than we'd expected previously, exacerbated by what's been going on with U.S. interest rates and the fact that we have the lowest historical interest rates in Brazil ever, and the implications of that for the carry trade and flight quality and things like that.

And then, I guess, the additional comment I would make just take to advantage of your question, we also have to manage this through the seasonality cycle in our business. And you saw this in our fleet management last year, we're basically between the trough of the year on capacity, which is more or less now, April, May, and the peak. We run a difference in operated fleet by 10 to 12 aircraft. And so, these numbers that we're guiding on the average aircraft on the year, but remember, that we also vary the capacity to reflect the seasonality of the year. And so, for example, in Q2, we have a much lower operating fleet, as you saw last year. And what that means basically is that we schedule things like Wi-Fi retrofit and structural maintenance during the seasonality.

So, not just do we have the ability to vary our overall fleet to match GDP growth during the course of the year, we also have a really good ability to match our capacity to the seasonal demand. And that also is reflected in these planning numbers. Even though we provide very robust annual guidance, probably the most robust you could find out there in the market for any airline, on a quarterly basis, I can say that these tools also apply, meaning that we also vary the capacity to match demand seasonally, and that also reflects in the revenue management and also what we do on the hedging side of the equation. Hopefully, that answers your question.

Q - Duane Pfennigwerth {BIO 7329167 <GO>}

Yeah. Just as a follow-up. So, in the first quarter, you saw 100% recapture. As you think about a longer term, - again, who knows if the scenario we're seeing today is the right scenario. But based on the scenario that we're seeing today in terms of fuel and currency, what's your longer term planning assumption with respect to that recapture rate? Thanks for taking the question.

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

Sure. Yeah, sure. You should assume like for your modeling purposes, a number around 70%. That's what we assume for our planning purposes, which is reflective of the composition of business traffic in the Brazilian market. When I say 70%, it would be of the net variation in WTI and currency. The Brazilian jet fuel is a basket based on WTI, Brent and the crack spread times currency. And so, when we guide the market on this, with our business, with our whole business, we recommend using a number of around 70%. The 100% we've been getting, thus far, this year is above average. It's been an above average recapture, and I don't think that should be assumed for modeling purposes.

But we continue to see solid demand growth here in Brazil in the domestic market in kind of the above 5% in our domestic market. And we continue to be the leader as the largest company, and we continue to lead fares and revenue management with more or less the competition following. And so, we feel like we have a pretty good grip on how to be managing that through this blip of a couple of months on the net effect on currency and oil prices.

Q - Duane Pfennigwerth {BIO 7329167 <GO>}

Thank you.

Operator

The next question will come from Josh Milberg of Morgan Stanley. Please go ahead.

Q - Joshua Milberg

Hey, everyone. Thanks for the call. I had a couple of very specific questions on your guidance. One thing that we saw was that at the midpoint, Richard, of your EPS guidance, did that imply an assumed FX of just under 3.5. (00:19:40)? And that is meaningful depreciation from where you were before with your prior guidance. And so, at the same time that you have that move, I mean, your outlook for aircraft rent didn't move much. So, I was just hoping you could touch on why rent itself isn't being more affected by FX. And if I may, just...

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

Yeah. Sure.

Q - Joshua Milberg

Okay. Why don't you address that one and then I'll...

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

Yeah, sure. Basically, as we've guided, like I said, we incorporated a – again, we're not providing specific guidance on oil prices or currency to the market. So, I don't think you should necessarily infer what you're doing there is taking our EPS guidance in reals and currency here directly. The main effect on EPS guidance is more of a conversion, if you will, and, in fact, on interest expense and a little bit on taxes there. So, it's not totally out of the exchange rate, but obviously, there is a conversion there of the Brazilian real earnings per share guidance to the ADR guidance, which – it's not a precise number on the exchange rate.

But on the aircraft side of the equation, we have been reducing the costs of, if you will, on an ASK basis, and also on a total basis, through a combination of better productivity and effectively lower operating fleet there throughout the year. And so, the main effect on – it's a combination of better productivity and lower aircraft is what I would say there. And plus, what we're also been doing on our fleet management of our leasing finance portfolio.

We – in GOL's first order with volume, we acquired 80 aircrafts. We did 40 in sale leasebacks and 40 in finance leases. Since the beginning of 2016, we started a disposition of those 40 finance leases. In 2016, the company sold nine aircraft. And in the first quarter of this year, we sold two aircraft. And so we also start to get into a more regular, let's say, monetization disposition of our lease finance – or finance leased portfolio over the next three to four years as we transition to the 737 MAX. And as we transition out of the 737-

NG 800, that also will involve, on a recurring basis, the monetization of aircraft and also a shift in our portfolio with an increasing proportion of finance lease versus operating lease.

Now, that cycle is just starting this year on a more limited basis. And so, it's not a big impact in that number, but there is a small impact there as well as we start to realize the gains on the earnings on a regular basis over the next three to four years. And you'll start to also see that effect in our result. And it will become a more permanent component of our results also because as we build our portfolio of the 127 737 MAX 8s, we'll be doing a similar process or we will be building up about 60 finance leases over the next six to eight years and the corresponding equity guide.

So that tends to come into that number as well when you look at more the 2019 guidance that we're providing there, which also does not have a big increase on those costs. But the main driver is increased aircraft utilization and higher productivity that we're squeezing out of the assets. And then the secondary component would be just that we're going to be operating with a lower average fleet this year. Plus, we have all exchange rate assumptions in there in terms of what we think, which don't necessarily need to be yours, but it's never a good idea just to kind of lock in today's oil prices and today's currency when they hit the peak and assume those for the rest of the year. That would be probably not a right assumption to use there. And so, what we're assuming on currency and oil prices for the rest of the year is reflected in those numbers, and you can infer from that as you want. Sorry, you had another question?

Q - Joshua Milberg

Yeah. No. No. Yeah. I was just going to ask, I mean, what are you assuming for additional gains from aircraft sales over the remainder of the year? That was obviously a big impact in the first quarter.

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

Well, nothing specific as it depends on our - as we - those things can't be put on a regular basis, they're kind of chunky when we negotiate the deals because we also do that in conjunction with deals on new aircraft. All I can say there is over the next four years, our plan is to monetize all those aircraft. Those 29 will basically be sold over the next four years as we transition to the 737 MAX, but we don't have a specific planning on that.

We don't have any others negotiated, for example, for Q2 specifically, I can tell you that. But it depends on the deals we could negotiate. We could potentially have some additional gains in 2018, but nothing finalized yet at this point. But over the next four years, all those 29 aircraft will exit our ownership, if you will.

Q - Joshua Milberg

Okay. I get that it's kind of lumpy, that it's not very predictable exactly when you may have sales, but is the profit that you guys generated in the quarter on the aircraft sold maybe a good indicator of what we could expect for future sales?

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

Well, I mean, obviously, it depends a lot on the negotiations because when we do that, we also negotiate the lease return conditions, because you also see in our cost side, it's very expensive to return aircraft. And so, we also have the cost of returning the aircraft that we also negotiate sometimes as a package deal. But the profit that we realized in the first quarter of 2016 per aircraft was about half the profit we realized in Q1. So, if you probably took the average of those, that would be a good number to use.

And then what I would just say is that you can assume that those are going to be on a regular – let's say, on a smoothed out basis, over the next four years, those 29 aircraft remaining will be disposed. So, you could divide that 29 by 4, and assume they would have that cash flow coming back into the business over the next four years.

But it'd be about somewhere between around $350 million of cash flow coming back to the company over the next four years vis-à-vis the monetization of those aircraft. I would say the exact quarter of those is difficult for us to guide on or assume a commitment because it depends on negotiations. But you could assume that, that's going to happen one quarter per year over the next four years, and I think that would be pretty close to what ends up happening.

Q - Joshua Milberg

Okay. That's very clear. Thanks.

Operator

The next question comes from Mike Linenberg of Deutsche Bank. Please go ahead.

Q - Michael J. Linenberg {BIO 1504009 <GO>}

Oh, hey. Yeah. Good afternoon, everyone, and good quarter. Rich, I have a question just on the guidance as it relates to the leverage. So, previously, it was 3 times on a net-debt-to-EBITDA basis, and you're going to 2.8 times. Now, it looks like the EBITDA margin is the same. So, it looks like that there's improvement on the net debt side. And I'm just curious, with the movement in the currency, is it that whatever the movement has done that has maybe made the debt higher in real terms is maybe offset by a faster pay down? Are you deleveraging or paying down more debt quickly?

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

No. It's because of the other part of the equation, which is cash flow and cash, if you will...

Q - Michael J. Linenberg {BIO 1504009 <GO>}

Okay.

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

...in terms of expectations on cash flow and cash. And also, the main debt that's being amortized this year is not a dollar debt. It's a Brazilian real debt.

Q - Michael J. Linenberg {BIO 1504009 <GO>}

Okay.

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

And so, we have about BRL 1 billion of debentures, local currency debentures, BRL 400 million of which mature on October this year, and BRL 600 million in October of next year. And so we plan on amortizing those. So, those aren't affected. But the main reason is what I would say, just summary-wise, is just, let's say, a better certainty on cash flow, cash flow generation, working capital, how we're financing other portions of our CapEx program.

Where we are in the year now, we have much more visibility than we had at the beginning of the year on how we're going to be financing those. Those are generally engine maintenance, engine overhauls, and Wi-Fi retrofits. And so it's a combination of those factors, but also, when we gave the preliminary data to the beginning of the year, it was indeed a bit more conservative as we're just starting the year, and now, we have a firmer grip on that. So, that's what I would comment on that.

Q - Michael J. Linenberg {BIO 1504009 <GO>}

Okay. Okay. That makes sense. And then when we think about the amount of debt that you have in foreign currency, and now looking at the real at BRL 3.60, you mentioned a point that rates are the lowest in Brazil that they've been ever. And so, maybe there's an opportunity to maybe swap into more real-denominated debt, although I think a lot of it has to do with where you think the currency is going.

And like you said earlier to Josh's question, we could be – maybe we are at a low point with respect to the real versus the dollar and/or a high point as we've seen this recent surge in energy prices. So, maybe that's not the right thing to do, but if you look at over the next year or two, and maybe you are concerned that there could be further depreciation, are there steps that you're looking at maybe to kind of move away from U.S. dollar-denominated debt? And I realize it's probably baby steps, but are there things that you can do? And I realize there's probably two or three questions within that one question, so however you want to answer it. Thank you.

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

No, that's fine. It's a good question. Now, our policy, we – the majority of our CapEx is dollar denominated. I mean, the aircraft we buy, while they don't go into the financial statements in dollars, it's a dollar-linked asset. And so what we do is we match the assets and the liabilities on a currency basis. The problem is because our functional currency is Brazilian reals, when we buy the assets, they become denominated in reals and depreciated reals, and the debt is in dollars, and then you have that accounting exchange rate variation, which is noneconomic. And over the life of the asset, it's zero.

But having said that, the point that you're making, the Brazilian interest rates now are almost at the point where they could be competitive with our cost of funding in U.S. dollars, with the problem being the tenor, the maturity. And so, it's still more economic for us to finance the acquisition of our U.S. dollar assets with U.S. dollar liabilities and then just deal with the accounting exchange rate variation, because the cost of hedging of that would make - it makes it uneconomic. And so we would actually be destroying value if we were to take our U.S. dollar debt and swap it back to reals.

And remember that while a secured cost of debt - I'm sorry, unsecured cost of debt, the (00:32:18) rates there have a 7% coupon, our unsecured cost of funding on the secured assets, which is the majority of liabilities, is in the range of around 5% to 6% all-in blended cost of funds. And it's (00:32:36) 12-year cost of money, 5% to 6% in dollars. It's still - with the cost of a swap, it's still not cost competitive. But the only benefit we would get from that, we'd be eliminating the accounting exchange rate variation on the liabilities, which is it's accounting, it's not economic.

And we have - you're starting to see now, obviously, the cycle of the assets, is up to a 12-year cycle. The first aircraft we received in our first order of 737-NGs in a finance lease format was 2006. And so, we're just now coming to the end of that cycle. And so, you're starting to see, if you will, the capital gains of that investment come back. And those amounts obviously - those aircraft are traded in dollars, as you know.

And so, these gains that we're realizing today are actually - they're realized in dollars. And they've always been latent (00:33:30) in the portfolio. And we can't mark-to-market the asset, we can't accrue unrealized gains. And so we're starting to realize those gains now. So, those also go into the calculation. But unfortunately, it's not cost effective to eliminate this accounting volatility earnings (00:33:49) because of the dollar liability.

So, the short answer is no, we're not at a number yet where it makes sense for us to swap our - what I'd also tell you, and you understand this, is as we look at the 737 MAX aircraft, we're also - the secured financing for those aircraft, we're also diversifying our liability base away from the U.S. market, meaning we're looking at funding opportunities now that exist in other markets to us, which also have the potential to diversify the liabilities and reduce the risk and the volatility.

And so, I think next year, you'll start to see in our portfolio - in the aircraft business, because you always have to keep in mind, in our business, you have - we have three businesses. We have the aircraft acquisition and finance business, we got the passenger transportation business, and we got the loyalty business. And we manage those three businesses economically with different asset and liability profiles. But in the aircraft acquisition business, next year, we're really going to start do some more secured financing. And there are some interesting opportunities for us to do financings in other currency which reduce the cost of var, increase the diversification, kind of more like you see in the larger international airlines. But it's a long way of saying no to the answers to your question.

Q - Michael J. Linenberg {BIO 1504009 <GO>}

Okay. So, instead of reals, maybe do like a JilCo (00:35:16) deal, right? That's what it sounds like.

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

Yeah. Japanese market, Chinese market, there's also a lot of other options in the leasing market, but basically, Japan and China complementing the U.S. And as you know, the (00:35:29) market is 3% to 4% cost of funds and potential to do (00:35:34) also. And so, we study a lot. This is, in fact, economically our business. In that business, which is different from the – where the main focus always is, which is on the sale of tickets and transport of passengers, but on this asset side of the business, we have built up in the past, some substantial equity value in that business, and we expect to continue to do so. But that's kind of early days. I think that's not going to impact much our results this year, but it will definitely be creating long term value for our shareholders. We're excited about it, but I think you'll start to see it next year more in our results on the liability side.

But I know this is kind of a controversial issue, but still, the combination of the tenor locally combined with the swap costs, it's still more economic for us to finance our U.S. dollar asset acquisition in U.S. dollars. That's still more competitive. And then, especially on the secured side, because again, we're talking – you have to look – you have to study – you see this in the financial statement, in the footnotes, but our funding costs on a secured financing are 4% to 5% long-term money in dollars.

It's hard to compete with that on a – the Brazilian real market, it's much harder to go. You can't really go much longer than five years, and kind of a structural impediment for us when we think about our assets. The only other option, Michael, is we have to change our functional currency to dollars, which we also do not consider. But that was the only other way to kind of, from an accounting perspective, flip that around, would be to change our functional currency to dollars, for example, like LATAM (00:37:21) does. But we always come back with the conclusion that the right for us is functional currency in reals, assets in dollars, liabilities in dollars.

Q - Michael J. Linenberg {BIO 1504009 <GO>}

Yeah. No, that's super helpful, Rich. I really appreciate it. Thanks.

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

Thanks, Michael.

Operator

The next question will come from Savi Syth of Raymond James. Please go ahead.

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

Hey. Thanks for the questions. Your top line execution is clearly very strong, and you're demonstrating kind of willingness to adjust to the macro environment. Could you share what you're seeing from a competitive standpoint, if you're seeing that similar in discipline from a competitors on a capacity or pricing front, both in the domestic and international markets?

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

Hi, Savi. Kakinoff here. Yes. The answer is yes, which is possibly the most positive outlook you can get at the moment. We do see a much more disciplined market with regard to capacity. And that's something that we are also somehow accumulating once we are clearly delivering our guidance, showing that our first priority is really to keep a tight leash in our cost control, which reflects into our capacity discipline. So, I believe that, and I do expect that the market will continue to behave like this.

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

That's helpful. Thank you. And if I might - I don't know if it's Kaki or Rich, on the gains on sales, it was really helpful to kind of understand the monetization of the kind of equity built in those aircraft. But is it fair to say that you won't be giving all of that back in terms of operating lease payments and maybe return costs as you - if you look across, with the remaining part of the contract essentially. That there's enough kind of monetization built-in that you're actually generating more than you're kind of borrowing from the future?

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

Not sure if I understood the question. But maybe could you repeat the question? I don't think I understood which part of the...

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

Sure. So, when you do these gains on sales and you're releasing back the aircraft, I'm guessing the lease payments might reflect the - kind of the sale price. But I'm wondering if maybe it does (39:58)

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

No, no. I actually - got your question there. No, what - I got your question there. I mean, the - in some limited cases, we would be doing a short-term leaseback. For example, the deals we did in the first quarter were like a very short-term lease. It was like a - bit like three to four years leases. It's really just - because we're bridging ourselves to the arrival of the 737 MAX 8. I mean, our objective over the next 10 years is to eliminate the NG from the fleet.

And so, in some cases, we would be doing a leaseback. But, for example, at the beginning of 2016, the nine aircraft we sold left. I mean, they were just sold to a fund then invest in (40:34) aircraft. And so - but, well you can assume the way we do these deals, when we do a leaseback, we're minimizing the monthly lease payment. And so we're always minimizing the monthly lease payment. And then, the - if we do a sale leaseback, we minimize the monthly lease payment and then, if you will, the purchase price is kind of like the plug for that because we always focus on having the absolute minimum operating cost.

And so, we're always minimizing the monthly lease payment. So, this all gives back, if you will, on a lease payment for us. What I was trying to say before is that, in the case where we are retarding an aircraft, there are - aircraft is very expensive to return and so sometimes what you also have to look at is that the return costs - the company has spent $700 million over the last couple of years to return aircraft. Not just normal returns but also that 29 aircraft reduction that we did in 2016. That's very expensive.

And so, another way you could potentially look at it is you could take the gains on our monetization and then offset those against the cost. For example, the aircraft was sold in the beginning of 2016 which generated around BRL 220 million of profit. The cost to return those aircraft was a little bit lower than BRL 200 million, but over the course of the whole restructuring if you will. In other words, the nine aircraft that were sold effectively paid the return - more than the return cost of all 29 aircraft that were taken out of the fleet.

And so, sometimes we're doing those calculations where we're financing other activities with these gains from a cash flow perspective. Because everything we do here, be it on the capacity side, be it growth domestically, growth internationally, all has to have to have a financing source operationally, be it operating cash flow or, in the case of a sale, an aircraft. And so, sometimes the timing on that is not matched.

And so - but that's something you can also do because we do - we have presented lease return conditions, there are also provisions in our balance sheet, in our footnotes, and so that's something also that we could talk about offline if you want to understand it. But like I said, the gains are in excess of the lease return costs. If there's a sale leaseback involved, we're always focused on the lowest possible monthly rent.

And in fact, part of the reason why our leasing costs have been going down is we've been successful at negotiating good deals on these new rental contracts - contract renegotiations as well as new contracts, we've been able to keep negotiating good deals on those. And so, while you don't necessarily assume that a gain on a saleable lease - sale of a finance lease aircraft is a direct reduction in CASM, keep in mind that we also have these lease return costs, which are being counted for in the CASM. And so, there is a partial credit and lease (43:51) that should be given for this, or you should exclude the - perhaps exclude the lease return costs from your CASM calculation if you want to compare it apples-to-apples to other airlines for example.

But also, we provide all these data, how you guys want to do it, just let us know. We can - we're always available to help kind of explain in different ways, so that you guys can come to the correct economic profit of the company. So, that's what I would kind of just provide to you information for the expense that you're looking at.

The other point I was making was that we are - these 29 aircraft - I mean, we went from 31 to 29 aircraft in Q1. All the next four years just because of the maturities of these finance leases, we will be disposing of these aircraft. So, those 29 aircraft will go out. If we - if they're an outright sale or we do a three-year leaseback, that's always negotiated at the moment and also how we deal with the lease return conditions.

And also, as you know, what we want to do is we also deal with the leasing companies, the operating lessors, we can also trade slots with them in the Boeing factory if we want to get a 737 MAX 8 sooner. So that sometimes what we do in a deal is we'll trade a later delivery of a 737 MAX 8 for an earlier delivery of a 737 MAX 8, so we can accelerate the change of our fleet for the more fuel efficient 737 MAX 8. So, it's a complex kind of calculation.

And part of what I'm saying is that don't look just at one leg of a - we have the gains, we have the lease rates, we have the 737 MAX 8 orders that are coming in and we also have our new finance lease portfolio that we're going to be starting to build up next year. They all kind of go into a complex calculation that happens over a 12-year period. But it does create a lot of equity value for shareholders in GOL. And it is a regular part of our business. Similar to what you've see, in the other large 737 operators like Ryanair and Southwest, we're one of the top 5 737 customers for Boeing. And so, those economics - we're still a relatively young company when you talk about owned aircraft.

Like I said, the first aircraft - first finance lease we have was 2006. And the finance lease matured on that 2018. And so we're only at - we're like at the end of the first cycle that we did on our first order. But now, we have kind of a regular operating procedure for that. And so, I think, you can start to think about how you would look at that and the value of GOL going forward.

And we're also trying to explain how we approach that. I appreciate the question. I was just trying to take advantage of your question to kind of give a little bit more information as this is kind of a new part of our business that is showing up and help you guys understand it.

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

That's super helpful, Rich. And if I might add, just a quick clarification question, in your operating cash flow discussion you mentioned some extension of payments related to accounts payable. Just wondering what that was?

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

Related to what, sorry?

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

Sorry. In the operating cash flow discussion, you talked about some extension of payments in - related to accounts payable.

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

I'm sorry, comps table, I didn't get the last word. Sorry.

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

Sorry. The accounts payable, there is some (47:13)

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

Accounts payable. No, no. What we - that is just generally what we have been working on over the last 24 months. Like, if you mine down into the cash flow, you'll see two things. Number one, the main source of improved operating cash flow has just been operating profit. But the second main source, and it's not very sexy, has been working capital, which is payment terms. And so, what we've been doing over the last, call it, I guess 21 months now is just a constant focus on getting to a new level of structural supplier terms.

And so, if you go back to the like Q2 2016, we were around say 25 days payment terms. Now, we're around 40 days. And so, every quarter, we are - we're still working on some improvements, but we're more or less getting to kind of a structural maintenance level where our objective has been to zero out the effects of working capital on our business.

And so, when we say - of course (48:11) the Q1 is being compared to the Q1 of last year. And so, we did have continued increase in payment terms by about eight days in the quarter-over-quarter comparison, and that means that we're generating cash - we were generating cash also on the working capital side of the equation, which is suppliers across the board, suppliers and accounts payable. That's what we mean when we talk about that.

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

Great. Thanks so much.

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

Okay.

Operator

The next question comes from Dan McKenzie of Buckingham Research. Please go ahead.

Q - Dan J. McKenzie {BIO 15071178 <GO>}

Oh, hey, thanks. Good morning, guys. Rich, I'd like to go back to the - an earlier question just on revenue recapture. It's been a 100%, but I guess you're telling us to think about it being more like 70%, and it seems like a pretty big shift from one quarter to the next. So, the question is, what is it that you're seeing to think more conservatively? And just to preface the question, Brazil's 2.5% GDP. It seems like business demand is pretty inelastic right now. So, the caution just simply because we're going into the seasonally weaker part of the year, is it a small step up in domestic capacity perhaps? Or are you sensing that pricing might be getting pushed here to the point where it might begin to affect demand? Just wondering if you could elaborate a little bit more on that.

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

Yeah. Now, that's a good question. It's about 80% of everything you said. Meaning, first point is that this - what I - I mean, we like to help people like simplify the modeling. And so, you don't have to mine down into what we're doing on yield management or hedging management. What we kind of say is that, if you take statistics and apply logic, you can basically assume that your – for your modeling purposes, use the 70% recapture and assume a negative one (50:09) correlation between WTI and Brazilian currency and use WTI as the proxy for oil prices. And if you do that over any period of time, you would always get it right. Of course, we have the – you have the dislocations that can happen over a three- to six-month period. But generally, it don't last much longer than that.

And so, those are just numbers that – we're kind of sharing our experience with you to try to give you an approach. But in the short-term micro, a couple of factors. Number one is that, yes, there is still decent pricing power. Yes. Right now, April, May is kind of a low seasonality time of the year. And so, there's just much less demand in Brazil and that's because of the reduction in the non-business traffic and so on. And so, what we do there is we try to manage our capacity where we're scheduling our structural maintenances on aircraft during those time periods to try to better match. But there is a weakness that happens.

And so – and then, but then, what affects that is when we get a rapid run up in currency which is – which goes into the jet fuel equation. We're – we generally are for (51:26) sold up in 90 days. And so 30 days out, we do the yield management, but 30 days out, 60 days out, I mean, we've already sold a fair amount of tickets at old prices. And so, we get a quick run up like we got here in March-April. The ability to recover, for example, May is much more limited. And so, when you get a quick run up, it squeezes a little bit there.

And then the final point I would say is, you hit on it, which is Brazil is in a mode now where you do have demand growing, let's say, almost at twice the rate of capacity increase on average, which gives us good pricing power. But we also are trying to stimulate the other segments of the market, VFR traffic, for example. And so it's important for us also not to lose sight of the forest for the trees, meaning not lose sight of stimulating demand and creating passenger traffic in the non-business segment versus just a focus on squeezing every cent we can out of a short-term dynamic.

I mean, we provide a public service, right? We have to provide passenger transportation to the Brazilian market. We're the largest company in Brazil. So we have an obligation to basically be providing an inventory of seats that is going to serve demand. And so, we have to balance all those factors, the pressure on short-term results versus improving our overall business. And so we also want to make sure we have an inventory of seats that is available at demand-stimulating fares which is also in – it's a combination of that. But obviously, we're doing optimized yield management. As you've seen over the last, now almost 24 months, we've been running at pretty close to a 10% year-over-year annual unit revenue increase, which is well in excess of inflation and it's been absorbed in the market, but we have to keep our eye not just on the business component but also stimulating demand for the market.

And of course, everything I'm talking about here is the logic and the answers I'm giving you are in the context of the domestic market. Obviously, the international market is much more impacted short-term based on a big increase in currency because it's a much more leisure – especially for a Brazilian company like us, it's much more leisure-based so it's much more sensitive to fare increases and much more sensitive to the dollar side of the equation, because those ticket prices are denominated in dollars and the impact is almost - a big chunk of them are denominated in dollars, and so, the impact is immediate.

I just want to say because everything I was just responding to you think about it in the context of domestic market. Obviously, that's the key driver of our profitability. But just, are we being conservative? Always. We'll always being conservative in terms of what we're guiding there. Is it stretched now with the current level of currency, yes, there's a lot of pressure on the currency side. But again, most of the impact there is not coming out of stuff happening here in Brazil economically. It's coming because of the external scenario, principally U.S. interest rates and what's going on with that dynamic that is impacting the currency. And there's a little bit of election volatility in there.

Also in an election year which we are starting now pretty soon, generally we've seen an increase in passenger traffic so that will be in there also, but just kind of step back. Obviously, Q2 is a down quarter for us seasonally anyway. There's more pressure now on kind of the March, -- sorry, the May, June just because of the quick run up. But obviously, we're managing in that but we do see a pretty good back half of the year at this point in terms of bookings and our ability to adjust fares.

And so, I think if there's any pressure, it happens now in the Q2 just given that really sharp run up in kind of April which doesn't match with how yield management works which is generally you're working kind of on a 90-day forward booking side (55:41). Of course, everything I'm saying applies to Brazil. It's different in the U.S., it's different in Spanish-speaking countries. I think the ability to extrapolate to other markets should be cautioned against.

Q - Dan J. McKenzie {BIO 15071178 <GO>}

Yeah. Understood. Thanks, Rich. That's really comprehensive. Just kind of elaborating on that point even a little bit more, is there kind of an accrued, just using negative correlation of one, is there accrued FX scenario where in your view it might put - start to wear you from kind of a stress point on the business or is just the economic backdrop strong enough to just power through? You kind of pointed out election year volatility with respect to FX.

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

Yes, yes, yes.

Q - Dan J. McKenzie {BIO 15071178 <GO>}

How robust do we feel we can - how we can power through that?

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

I would say obviously it depends on how much time we have to work on the yield management. I think with this quick run up we had now, it's kind of in - it's at a high pressure point. Meaning, the market needs time to absorb these current levels. But I think the probability of us seeing this, this is - you have to know, over the last 15, 20 years, there's only been three points in time in Brazil where we had jet fuel at these levels and there were just peaks that lasted for about 30 to 60 days.

And so, I think we need to keep that in - but I think the point there that would be the scenarios would be what's going to happen with U.S. interest rates and that part of the dynamic. I think the Brazilian election dynamic should not be unexpected for anyone. We did expect to see some higher volatility there in this period of time given the lack of leadership on that issue. So, that shouldn't be scaring anybody. I think the issue of U.S. interest rates, it's a little bit harder to, say, figure out for the entire market, not just to Brazil, not just the emerging market, for the entire world right now that's going through that.

But, yes, where we are right now on these levels, it is going to take a couple of months for the market to absorb, and so, that's - it's a big pressure - it's a big pressure right now. It's kind of at the limit of, let's say, what the market could absorb in the short-term with what - with - in other words, if fares will increase substantially about certain levels, it could potentially have a dampening effect on demand.

But against the backdrop of 2% to 3% GDP growth in Brazil this and next year (58:13) and the re-initiation (58:14) of economic activity which is in Brazil, as you know, we only two ways to travel long distances. It's either by air or by buses, and corporate travelers are not traveling by buses for their business activities, they're traveling by air. And so, when you see in the Brazilian system these load factors at the 80% level, you definitely should read into that that demand - and with the unit revenue increases, that we're getting very healthy demand and profitable demand at those levels of load factors which are in favor of continuance of this good supply/demand balance and good pricing power and things like that, including potentially addition of capacity to meet this demand. We revised down capacity a bit this year because in our way of managing the business, we effectively can pay for our costs with reduction in capacity.

And so, it's - what's one of our tools in there is when FX or fuel or a combination of the bulk get at certain levels, we also work with the capacity tool. But none of that should be read into here as - (59:26) I mean, we're having very solid demand, really rational capacity, and I think there's more arguments than not for - at some point, perhaps it's beyond the election cycle, meaning once there's just kind of a more immediate confidence on what's happening, then we should just go back to this - what was, I think, kind of boiled into people's expectations, say, three or four months ago.

Q - Dan J. McKenzie {BIO 15071178 <GO>}

Thanks, Rich. Appreciate it.

Operator

The next question will come from Rogério Araújo of UBS. Please go ahead.

Q - Rogério Araújo

Hi, guys. Thanks for the call. I have a couple of follow-up questions regarding the guidance that was released. The first one is on cargo and other revenue line. The guidance says BRL 1.2 billion, and this is 11% of the revenue. But in the first quarter 2018, it was delivered 5.5%, half of it. And this is related to new accounting. So, my question is what is going to be the sustainable level in the upcoming quarters? Can we rely on this 11% or is it more towards the 5.5% we saw in first Q? That's the first question. Thank you.

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

So, you should be using the numbers that were provided in the guidance. I mean, yes, there was an accounting - there's an accounting change across the board, basically where the revenue recognition component has changed. You saw this in our Smiles business as well. And so, use the numbers in our guidance.

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

In a prolific market approach, the trends are pretty positive. As Rich had mentioned before, this the exchange rate volatility is much more related to the United States' new financial structure than any kind of Brazilian market cooling down. So, I'd say that in cargo, just mentioning one of the ancillary revenues that you have mentioned, is performing quite positively. So, the changes are pretty much related to the accounting method.

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

Yeah. When we - because when we did the previous, we didn't have 100% visibility on a couple of components in the accounting. And obviously, the main impact there is not cargo. The main - no, because cargo is about - it's about 25% of that number. The main impact was on the loyalty program, and then some of the other things that we did - the revenue recognition moment changed. And so, that's really what's driving that. It's not related to the business or economy or exchange rates. The - those businesses tend to be more domestically focused in our cargo business.

We provide in our monthly stats - and I encourage you to look at it. We provide our volumes on the cargo business which tends to be a leading indicator of our overall economic activity, and also the sale of tickets. And so. we've been providing that number now for a while. As you can see, kind of the growth trend in the cargo business using those numbers, and then of course you have the full disclosure on the Smiles number. We continue - we're getting healthy revenues from our - from the other components there and - such as excess baggage.

But remember, just to make clear, just in case people don't understand what the accounting changes are, a portion of those other revenues are now accounted for - as of 2018, a portion of what was previously accounted for as cargo and other has moved up to passenger revenue. So, it's just a transferal from that line to the other line. It has no impact on RASM for the most part. It was just a geography issue moving from other revenues to PRASMs, and this affected the whole world, in other words. So, today, all airlines in the world are comparable apples-to-apples on a PRASM basis because of these changes. So, a portion of what was previously in the other revenues moved up. The only thing that was left over - well, anyway, I'll just leave it at that. And this - and all of our numbers now are, on a quarterly basis, are restated on this new IFRS 15, which – so the first quarter numbers you're seeing there, the first quarter of 2017 is also restated on that basis.

Q - Rogério Araújo

Okay. Sounds clear. And the second question is just a confirmation here. Does GOL guidance include this additional increase in the tickets fares versus the current level and by how much? Thank you.

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

Again, we don't manage the business focused on any one particular line item. We focus on operating profit, that's how we manage our business, that's how the employees make their profit sharing. And so, the focus is on that. And so, where we end up on a fare decision, on a cost decision, on a fleet decision, they're all related to that.

And so, how we're going to be managing our fares is based on market, based on demand, based on capacity, based on revenue management, and so – and it's complex. And we have a million fares in the system as we speak. And so, it's a complex management that's happening. So, there's no way I can answer your question of saying what's reflected in a future fare increase or not. It's not possible because we're doing an active management every day on that. And so, our focus – so, another way to say is that - is the management of what we can do reflected in the EBIT margin? The answer is yes.

Is that what we expect to be doing on revenue management from here now to the end of the year is reflected in that number. But that could change. For example, if we got – if we had a 30% decrease in Brazil – if we had a 30% appreciation in Brazilian currency over the next six months, that would have a downward pressure on fares.

Where we don't – in terms of the modeling, we would only keep 70% of the upside. We would not assume to retain 100% of the upside. This is a very high correlation with the currency rating. So, that will also depend on what happens with the currency through the rest of the year. And as we get into the back half where the demand is stronger, our capacity is higher.

But in the short-term, another way to answer your question, I would say is, yes, we're very focused on trying to keep the historical recapture on cost pressures through the revenue line such that we maintain our annual targets for EBIT margin. But as I was saying before in a previous question, there is pressure in Q2 especially April-May just given the very quick run up vis-à-vis the forward-looking curve.

But kind of June going forward, it's a more balanced approach. So, that the pressure is really, in the context of the year, feels like it's going to be over a two-month period. But we don't – like I said, we don't have visibility all the way through the end of the year. So, we're going to have to see what happens on the jet fuel side of the equation as well as the currency. But obviously, the oil price component has the larger effect on the operating margin vis-à-vis the currency. And then, you have to look at the correlation.

So I mean, it would be very abnormal to see oil staying at $70 and currency staying at $350 for the next six months. That would be a very significant deviation from – in other words (01:07:22) you have to bet significantly against statistics and logic to win that bet if you're going to do that. So – but I know it's possible because there's a lot of uncertainty now with interest rates coming out of the U.S. and a little bit of uncertainty about who's going to be the next executive of Brazil. But like, for the most part, the economic management is solid. It's in the right hands. Our sector is doing quite well. And so – but as – all these planning is in the numbers that you're seeing there, from the management of this company.

Q - Rogério Araújo

Thanks very much.

Operator

The next question comes from Petr Grishchenko of Barclays. Please go ahead.

Q - Petr Grishchenko {BIO 19084897 <GO>}

Good morning, and thanks a lot for taking my questions. Just a lot of them were already answered, of course. Just wanted to understand a little better your – given your exposure, customer exposure particularly to the business segment that's fairly sensitive, (01:08:25) of course. How do think your market share in Brazil would evolve this year? Maybe if you can also touch on the international routes where we saw about last year most players are ramping up flights to Europe and the U.S. and how do you think the recent devaluation would affect those plans?

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

Petr, we don't see any reason to believe that our market share would go below the current level, the total market share. We are holding 36% of the market and I think that is (01:09:04) sensible position. We could go even higher in our business segment share considering the probable (01:09:12) improvement we have just deployed. We are around 90 from (01:09:20) current 120 aircraft being already available serving the routes fully retrofitted. Up to the end of the fourth quarter, we have 100% of the customers in every route experience the new GOL product and service which is likely to further improve our business service market share. This is what we do expect.

And finally, the demand, as Richard already said, the short-term demand for international airline tickets, they are supposed to be affected considering the current exchange rate volatility. Typically, in this kind of rally, you do see a short-term customers' behavior change. But that's nothing that would seem to affect us considering that we are going launch the start of our United States operations by November, I mean, beginning of the Brazilian high season. So we were not concerned about that and we could also equally make some minor adjustments in the international capacity considering that this is one of our most valuable assets. Operating in the southern (01:10:49) fleet, we could easily reallocate the aircraft to serve a more demanding domestic routes, which is also likely to happen whenever you have this kind of reduction in the international flight as a business. Usually, the customer shifts to a domestic flight. And this is what happened where we had experimented in 2015. So this is nothing that should dramatically affect our sales performance.

Q - Petr Grishchenko {BIO 19084897 <GO>}

Got it. And just to clarify maybe briefly on the outlook. Did you say you assume 3.5 BRL (01:11:33) for this year or I misunderstood that point?

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

Assuming the what?

Q - Petr Grishchenko {BIO 19084897 <GO>}

The BRL rate, you assume on the revised guidance, was that 3.5 (01:11:44)?

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

No, we are not...

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

(01:11:47) you don't see currency (01:11:49) table we provided on our guidance. You don't see that there.

Q - Petr Grishchenko {BIO 19084897 <GO>}

Okay. And last, if I may, the constant EBITDA margin that you project for this year, I think you mentioned some reasons for that like productivity improvements. Are there any specific cost items do you expect to reduce or it just broadly like labor and maintenance?

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

Well, it's really possible because as we have gone back close to 12 hours of aircraft utilization, also as we transfer to the MAX, the bigger effect is (01:12:26) next year. There's a huge productivity improvement. I mean, on an annual basis, it's about 3% to 4% - on a unit cost basis, it's about 3% to 4%. And in addition to that, we also have greater revenue productivity out of the aircraft because the aircraft going forward will be a little bit larger. And so while we're having zero increase in the overall fleet, for example this year, the structural changes (01:12:56) 3% to 4% improvement on the cost side as well as 3% improvement on the unit revenue side. And another way of saying it is, it is operating leverage. The very high level of operating leverage that's in our model and it's in our business model.

And so that's, obviously, it's harder to appreciate if you don't have a good feel for airline operations. But it's really present in our operations because we're a high utilization airline. And so this 12 hours of utilization on a narrow-body short-haul business, basically means we have (01:13:32) we're working the aircraft 24 hours a day and that's been a gradual process of recovery for us over the last two years post restructuring of the fleet, where we kind of rebalance the capacity and demand here. But this 3% to 4% annual unit cost dilution is structural. I mean, it relates just to us incorporating the MAX aircraft into the fleet along the fleet plan that we provided you.

But in addition to that, don't forget the improving revenue productivity as well. Because the slightly larger aircraft and the slightly higher stage length and the slightly higher utilization basically means that our stores, our factories are producing more units that are generating those revenues with the same fixed cost base. But that's really what's in there but it's a couple of points of operating margin that is in there. And it's structural to us. It's a competitive advantage that we believe we have.

Q - Petr Grishchenko {BIO 19084897 <GO>}

Got it. Thanks so much and congrats again on the quarter.

Operator

The next question will come from Soummo Mukherjee of Mizuho. Please go ahead.

Q - Soummo Mukherjee {BIO 6619902 <GO>}

Hi, thanks and congratulation on the good quarter. Just assuming – I know that you mentioned many times that you don't think the current levels of FX and oil prices are sustainable, but just considering a stress case then just if we perpetuate the current rates to the rest of the year, we're talking about the BRL average that's currently at 3.24, averaging 3.40, if it's kind of at 3.50 for the remaining months or 3.45 if it's 3.60 for the remaining months. Would you have levers to play with in order to still maintain your guidance, or could we then expect the revised guidance in terms of leverage specially?

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

Those numbers you just cited there, there wouldn't be any reason to have any change on guidance whatsoever with the numbers you just cited. But the levers for us are, again, capacity management, revenue management, and hedging. Now we have about 10% of our foreseeable fuel consumption hedged at the low 50s for the rest of the year. That's a minor component. The major component is yield management. So it's just how we're working on doing the dynamic revenue management we do. And then you see what we've done in capacity management. I mean, that's not insignificant. And so those are the levers. I mean, those are the levers you have in an airline business, right. But the numbers you described there, I mean, those aren't anything that would change much there in that at those numbers that you've just cited.

Q - Soummo Mukherjee {BIO 6619902 <GO>}

Great. Thank you.

Operator

The next question comes from Walid Bellaha of JFS Asset Management (01:16:35). Please go ahead.

Hi, thank you very much for the presentation, and congratulations on the results. I just had a couple of questions, I think, which are kind of the follow-up to what has been discussed before. So Q1 was sort of an exceptional quarter in terms of margin when we look at it. I think there's the gain from the aircraft. There's also maybe the fact that you had higher proportion of hedge for fuel more than 20% whereby for the rest of the year we are below the 10%. So I just want to understand how confident you are in your price adjustments and the ability to do price adjustments because in terms of hedging fuel it's relatively limited. How confident that you are able to adjust the prices without affecting demand?

And my second question was regarding some of the restatements that you've done year-on-year. So I noticed that a few key indicators like the average fare, like the net yield have been restated up for Q1 2017. Just wanted to understand if you could clarify the reason behind these restatements?

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

Yeah, IFRS 15 changed a couple of points. One is revenue recognition, the point where you recognize an ancillary revenue. And the other effect was that everything – certain revenues that were previously reported, and this all airlines in the world, this is not GOL, are now included in passenger revenues, okay. Cargo is not included in passenger revenues and other certain additional charges are not. But the majority of ancillary revenues now are included in passenger revenues, but that's the main difference. And so the detail is in the footnotes of the financial statements which you have there. And starting in Q1 2018, every quarter we presented in that fashion. And so what you'll see is RASM, total RASM doesn't change that much but PRASM will go up a bit. This is for all airlines in the whole world.

In terms of your first question, Walid (01:18:52), I don't know how to answer that question other than how we've already answered it. I mean, we have active management of capacity and yields and fares and hedging as well. And so are we confident in our ability to keep managing the business proactively, to keep focusing on delivering results for our investors? 100% confident. Plus we're not in charge of the Brazilian economy. And so I think the – in Brazil, what we have is we're about six months now in front of an election in Brazil. Generally, across the possibilities, we don't see a scenario that would alter the economic management of this country, which I think was what everybody in business should be most concerned about.

And on the U.S. side, it seems like we're going to have to deal with this uncertainty for a while, right. That's affecting geopolitically interest rates and U.S. growth rate is also affecting that dynamic of the carrier trade between U.S. and Brazil. And then you have the potential oil price component, which is obviously, we spent a lot of time on all these factors from a risk management perspective. But in the Brazilian market, the key factors you need to focus on are disciplined capacity management across the board. And then how that's reflecting into – yeah, but we do yield management. And so yield management is always about maximizing your profitability for a given demand set. And if you have balanced capacity, you have a good chance of doing that.

The issues that are being developed, the quick run-ups, right, as I was saying on the previous couple questions, there's been a quick run-up in the currency. Oil prices have not run up much different than expectations, maybe $2, $3, but currency has this big run-up because of these international effects. And so that takes a while to get absorbed, right. And so that takes a while to get absorbed in many businesses across the board. But I can't respond in any other way. But are we confident in our ability to keep managing the business to maximize our delivery? 100%.

Q - Operator

Okay. Thank you very much. I think what I wanted to clarify really is whether you've noticed any change in the trend for the bookings over the past month. Have you seen maybe lower number of (01:21:32).

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

No, we're not seeing any, let's say, abnormal softness in demand or anything like that. I mean, demand continues really good. The issue is like I said before is that on our business like today right now, we have (01:21:50), right. So my ability to change the profitability of tomorrow's seats is pretty low because 90% sold for tomorrow. And so there's nothing we can do to change the profitability on tomorrow's flights or next week's flights or this month's flights. So, that's the squeeze that happens with this quick run-up.

That we do have a little bit of a benefit as there's more muted increase in our fuel price because Brazilian fuel prices are calculated once a month based on the average international Jet 54 plus currency. And so it's not as quick of an impact on oil. There is kind of a one month lag on the jet fuel prices. But on the exchange rate, it's immediate, right. And so then you have your management there. And there's been a huge run-up. I mean, everything has been down 40% over the last three weeks, right. That's a big chunk to absorb quickly. But, like I said, over time, over a 90-day cycle, we've been – we're confident that we can absorb that.

And so I think, as I was saying before, the pressure on us and I think the whole sector really just can't, April-May time period, just where we are in that cycle. Same thing happened in May of last year, and we hit 3.7 on the currency in May of last year. Nothing new here. I mean, this is just the reality of our business.

Q - Operator

Thank you very much. That's very clear and helpful. Thanks.

The next question will come from Matthew Berland of Gramercy. Please go ahead.

Q - Matthew Berland {BIO 20251815 <GO>}

Hi, thank you for hosting this call. I'm just wondering if you can give us a refresher on your hedging policy. I know a lot of it is based on the negative correlation between the BRL and WTI. But given what we've seen recently, have you thought about maybe exploring different alternatives, and maybe increasing your FX hedge because that seems to be what has historically gotten the company in trouble if you look back at 2015 and 2016 where you see that margin erosion. Thanks.

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

Yes. Back then, you had a misbalance of capacity way in excess of demand. I mean, the way we manage the business, again, just going to repeat what was already said is the first equation is a very disciplined capacity management which is based on a very sophisticated process, and then revenue optimization through revenue management. And then we complement that with hedging. On hedging specifically, no, when you get runs up in oil prices and in our currency, you don't start running after them by doing hedging. That's the exact moment where you should not be doing hedging.

How we approach it is that, we have very sophisticated policies and procedures where based on where we have - where we are in capacity and revenue management and pricing power, we then set hedge ratio targets and price targets and manage that very dynamically. I mean, I think the best way to describe things is kind of just look at our historical. So if you look at Q4, right, you look at Q4, you look at Q1, you can see how we kind of then manage it there. And so we have triggers actively set on our per fuel hedging as well currency. And so, to the extent we hit those triggers, we would put on those hedges, taking advantage of the volatility in the market, our backwardation and so on. But again, for us, just to kind of go back, I mean, we're focused on managing this business for operating profit targets. And so everything we do is kind of focused on that. It's not on anyone particular leg. We don't do (01:25:39) the U.S. Airline does, just try to lock in fuel price per liter, things like that. I mean, it's very specific to our business and our Brazilian business.

Over the last 15 years, you've had about 6 or 7 times where when there's been a crisis. Crisis or correlations go to 1 (01:25:55). And so, at that moment in time, either you're ready or you're not. And if you go back - because when you go back to end of 2015, you have to look at what's going on in these other dynamics. There was a huge excess capacity in the Brazilian market. There was a 7% run rate economic contraction in the Brazilian market at the same time that we had an annual - almost a 15% demand contraction, all those things were kind of happening at the same time, which is a very, very different environment than we have today. Very different. Very different.

Q - Matthew Berland {BIO 20251815 <GO>}

And then could you remind us on your interest in principal hedging policy. If I recall correctly, you said you weren't going to hedge any interest and principal (01:26:38)?

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

So how do we do it? How do we do it on currency is we go out 24 months. And we hedge what we call our medium-term obligations. We don't hedge the balance sheet from an accounting perspective, but we go out as far as 24 months both on oil exposure as well as currency. And all that goes into the bucket. Operating expenses, interest expenses as well as maturities in dollars all go into the bucket in terms of how we monitor our risk and how we manage that.

Q - Matthew Berland {BIO 20251815 <GO>}

All right. Great. Thank you.

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

Okay. (01:27:16) so we were able to, today, I mean with this new format that we're using, we were able to get through 12 very detailed Q&As, 11 sell-side and 1 buy-side over this period. And we were able to meet 100% of the requests for questions on this call. And so I appreciate everybody that participated. And hopefully this new format is working where we basically are posting the videos on the website, which basically give you what we would normally present on the webcast. And then that gives us a much more time for Q&A.

And so today, we were able to get through 12 sell-side and buy-side, got through the full list. Everybody's questions were answered. And so I would say hopefully this new format is working. But if you guys have any other questions, we can we can improve this format, or we can also treat them offline.

So, with that we're going to end, so we can go to our next event today, which is our call in Portuguese to our local market folks. So, with that, we'll go to the closing of the call.

Operator

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