Q2 2017 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

- Duane Pfennigwerth, Analyst
- Michael J. Linenberg, Analyst
- Savanthi N. Syth, Analyst
- Stephen Trent, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Welcome to the GOL Airlines Second Quarter 2017 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 the GOL website at www.voegol.com.br/ir and MZiQ platform at www.mziq.com, 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 their questions will either 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 begin.

Paulo Sergio Kakinoff {BIO 5160310 <GO>}

Good afternoon, ladies and gentlemen. Welcome to GOL Airlines second quarter 2017 results presentation. I am Paul Kakinoff, Chief Executive Officer, and I am joined by Richard Lark, our Chief Financial Officer.

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

Good afternoon.

Paulo Sergio Kakinoff {BIO 5160310 <GO>}

This morning as you saw, we released the quarterly numbers. The slide 2 shows that we had net revenues of BRL 2.2 billion in the period, an increase of 7% compared to second quarter 2016. Recurring operating income in the second quarter was BRL 37 million, an increase of BRL 187 million compared to the same period in 2016. Recurring operating margin was 1.7% in the period, an improvement of 8.8 percentage points. This is the first second quarter of operating profit for GOL in seven years.

Quarterly recurring EBITDA totaled BRL 156 million, margin of 7%, recovering from negative BRL 40 million in the second quarter 2016 when we got (03:06) a margin of negative 1.9%. GOL maintained its position as the number one airline in Brazil with a market share of 36% in 2017 according to the ANAC. The last four aircraft of the fleet right-sizing plan were returned with the fleet reaching the desired size for 2017 of 120 Boeing 737s, with 116 in operation and remaining four leased to a company abroad.

Net income in the period was a loss of BRL 475 million, after the Smiles minority interest, representing a net margin of negative 21.2%. This result has an impaired comparison with same period in 2016, since non-cash extraordinary gains recorded in the quarter were BRL 779 million. While in this quarter 2017, losses with exchange and monetary evaluation of BRL 226 million were recorded causing a negative effect of BRL 1 billion year-over-year. Net cash flow was positive BRL 392 million.

Operationally, the utilization rate in the quarter increased by 2.7 percentage points to 77.9%, and the average yield per passenger increased by 4.8% to BRL 23.2, resulting in a RASK of BRL 21.4, an increase of 10.2% over second quarter 2016. Excluding non-recurring expenses, which totaled BRL 12 million in the quarter, the total cash was BRL 0.21, an increase of 1.1% when compared to the second quarter last year. The recurring ex-fuel CASK had a reduction of 2%, reaching BRL 0.15.

Turning to slide 3, we see the return impacts (05:21) when we conclude the adequacy of our capacity, network and basis (05:32) to adverse economic conditions in Brazil. As a result, we had a decrease of 3% in ASKs and a 5% reduction in the number of flights compared to the same period of 2016. Our dealer (05:46) network launched in May 2016 was expected to serve higher yield groups (05:52).

As already announced, the reconfiguration of the 737-800 next-generation fleet will take place during 2018, increasing the number of seats by 5% from 177 seats to 186 without compromising on comfort.

In the next slide, number 4, you can see how focused we are on providing the best customer experience. In addition to maintaining high levels of productivity and profitability, short-term results will be driven by the implementation of new technologies and innovations. The #NOVAGOL campaign marks the beginning of a new cycle that combines our expertise with modernity and energy for a new and more attractive flight experience.

We remain determined to offer the best air travel experience with exclusive services to GOL's customers, such as: selfie check-in, new and modern aircraft with eco leather seats and Wi-Fi on board, frequent flights in the main markets, and integrated route system and low fares, also added by the Brazil's most on-time service.

All this is made possible thanks to our dedicated team of employees, who are the key to the company success, as further detailed on slide 5. Our low-cost base remains the main differential compared to all other airlines. We have a standardized single fleet which allows us to obtain lower crew cost, better spare parts management and higher utilization. Nevertheless, safety always comes first and we maintained our FAA certification as best-in-class maintenance.

In addition, we are a leader in the customer experience and continue to expand our onboard Wi-Fi infrastructure currently in 33% of our aircraft and with expectation to be completed by mid-2018. GOL has the lowest unit cost in Brazil, cheers. Where the company operates with presence, market fares are lower creating the GOL effect that is incentivizing more customers to fly for the first time.

Now before we should walk through quarter results, I would like to update you on our 2017 guidance (08:36). We plan a small reduction in capacity, around 2% or less, average load factor between 77% and 79%, CASK ex-fuel BRL 0.14, EBITDA margin between 12% and 14%, and EBIT margin between 7% and 9%.

Earnings per ADS after the minority interest in Smiles are expected to be between $0.57 to $0.78. Leverage measured as net debt over the last 12 months EBITDA is expected to be close to 4.2 times. The risk of no attainment (09:19) are market fares in the fourth quarter, external shocks and competitor capacity growth.

With that, I'm going to hand you over to Rich, who is going to take us through the quarterly financial presentation. Richard, over to you, please.

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

We had a solid June quarter. As you can see on slide number 7, we achieved recurring EBITDA margin of 7% and recurring operating margin of 1.7%. These numbers exclude about BRL 12 million in non-recurring costs in the second quarter. As Kakinoff already mentioned, this is the first second quarter of operating profit for GOL in seven years. Our net debt at the end of June was BRL 4.9 billion, which was down BRL 108 million from March 2017. In the quarter, our operations had a 3% reduction in capacity and an increase of 8.5% in passenger revenue per kilometer or PRASK, generating RASK growth of 10.2%.

Turning now to slide number 8, we note that even with the industry environment still difficult in the short term, strong demand for our services continues. Since the launch of our new route network in May 2016 just over a year ago, we have increased our load factors by about 2 to 3 percentage points. For the second half of 2017, we expect occupancy rates to be around 80%.

On slide number 9, you can see that our profitability calculated by EBITDA was positively affected by the 10.2% growth in RASK and a 1.1% increase in the recurring total CASK quarter-over-quarter. In this quarter, non-recurring expenses were BRL 12 million. The recurring ex-fuel CASK was reduced by 2% in the same comparison.

As a consequence, our recurring EBITDA increased to BRL 156 million in 2Q 2017 with a margin of 7%, an improvement of BRL 196 million compared to the second quarter of 2016. The EBITDA per available seat kilometer increased to BRL 1.38 in this period 2017.

Our net financials also in the quarter were negative by BRL 425 million as can be seen on slide 10. We had BRL 20 million in financial revenues in 2Q 2017, offset by BRL 445 million in financial expenses, of which BRL 226 million were non-cash exchange and monetary variations. In the same period of last year, we recorded BRL 813 million in the net financial result, of which BRL 779 million were exchange rate and monetary variations, also without cash effect.

On slide 11, we detail the change in net income after minority interest of Smiles between the second quarters, and here it's evident that most of the components of this variation were making positive contributions to improve net income which is a consequence of the company's operational improvement. However, the loss with exchange variation of BRL 1 billion with no cash effect meant that the net accounting result was negative by BRL 475 million. We therefore reported earnings per share of minus BRL 1.37 per share and minus $2.12 per ADS in 2Q 2017.

Operating cash flow generation was positive by BRL 504 million as can be seen on slide number 12. This operating cash flow margin was 22.6% in the second quarter. Total liquidity at the end of June was BRL 1.8 billion, an increase of BRL 253 million from the position at the end of March. Out of the operating cash flow, funds were used in investment activities BRL 110 million and financial activities BRL 140 million.

In the chart to the left on slide number 13, you can see the evolution of our total liquidity for the second quarter. We had BRL 1.8 billion in cash, cash equivalents and accounts receivable at the end of the June quarter. In the chart on the right, you can check out the evolution of our net debt and respected leverage over the last 12 months EBITDA which, excluding the perpetual bonds which are equity like, in relation to the LTM EBITDA improved to 4.2 times leverage. The average maturity of our long-term debt in this quarter excluding aircraft financial leases and non-maturing debt was 3.2 years and we have no significant short-term debt maturities. 22% of our debt is real dominated with an average interest rate of 13.4% while 78% of debt is dollar denominated with an average interest rate of 7.6%.

Ever since GOL went public in 2004, we've been working to help investors better understand the drivers that affect our company. As such, we're always bringing new and innovative ideas to the market, therefore on slide number 14, we show interesting methodology for measuring shareholder value gap. The iQ Value Index methodology applies market cap and target prices from the sell side analysts' average vis-à-vis the current market price. Adding the most recent net debt is calculated the company's current and actual EV to EBITDA multiple which is the iQVI is – the comparisons of the iQVIs of two companies shows the value gap between them. For example, the current value gap between Ryanair and GOL is 44%.

GOL's average daily trading volume was $5 million on the NYSE and BRL 24 million on the B3 during 2Q 2017, representing growth of 123% and 83% respectively compared to the same period in 2016.

And to conclude today's presentation, I'd like to review our fleet plan on slide number 15. We completed the process of returning the last four aircraft during the second quarter of 2017. We currently operate a fleet of 120 Boeing 737-NG aircraft, of which we operate with 116 in operations and the other four are in sub-leasing facilities outside of Brazil. In 2017, we will maintain a current fleet size at approximately the current level, and in 2018, we will resume growth and begin aircraft replacement with delivery of our first five Boeing 737 MAX 8 aircraft.

With that, back to Kakinoff for questions.

Q&A

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

Thanks, Richard. And before opening the floor for our audience questions, we received by mail five relevant questions from investors and analysts this morning. I would like to summarize them and reply for the benefit of all. A caller for ours will read the questions we received and we will answer them with a few support charts where applicable.

Q - Operator

Have you actually implemented bag season in June and how is it performing?

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

In June, we implemented our Light fare, which is a discounted fare for passengers traveling without luggage. This is being very well accepted by customers so much so that about 7% up for this cheaper fare. This has reinforced the GOL mission of popularizing air transportation services in Brazil, which is part of our propose since our inception in 2001. We invested heavily in communication training and the result is exceeding expectation so far.

Q - Operator

Operating cash flow generation was positive by BRL 504 million in the quarter. What should we expect for the second half?

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

The second quarter operating cash generation was significant at BRL 504 million as you said and reflects our efforts to right-size our fleet and increase operating profitability. GOL's team operations and partners have contributed all for the improvement in the company's cash position. We also reduced our most expensive debt by over BRL 100 million in the quarter. We expect that in the second half, we'll continue to see a recovery in the corporate market – the corporate sales market, and as GOL is the leader in that segment in Brazil, in the business segment, we expect that our cash position will continue to improve.

Q - Operator

Can you comment about your expectations for yield and PRASK trends in the second half?

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

We are confident that the scenario of expected economic recovery coupled with passenger demand growth usual for the second half will be captured in better yields. The return of the corporate clients responsible for about 70% of our revenue is also relevant to PRASK since the segment is price-inelastic. We are looking to improve the mix between corporate and leisure even further.

Q - Operator

On ancillary revenue front, what are the main drivers for this growth?

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

We expect an improvement in cargo unit prices for the second half. Also we are working on increasing onboard sales and leveraging our GOL+Conforto space.

Q - Operator

Okay. And are you planning any equities follow on?

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

No. We have no plans to tap the capital markets at this time. Our liquidity is increasing, and we have over BRL 500 million of additional liquidity sources if needed, as mentioned in the previous quarter's conference call. In addition, the profile of our debt has been restructured so that we have no significant short-term maturities and our debt maturities are scheduled over the next seven years, matched with our cash flows.

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

And now, I would like the operator to open the floor for further questions of today's call.

Operator

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

Q - Duane Pfennigwerth {BIO 7329167 <GO>}

Hey, good afternoon. Just on the second half expected recovery in corporate, I wondered if you could expand on that comment a little bit and specifically did you see any of that in the current quarter or was it more driven by leisure strength and what gives you confidence that you're going to see improvement in the second half?

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

Hi, Duane. This is Kakinoff here. Good afternoon. Actually you have. By the end of the second quarter, we saw some acceleration in the demand for both types of customers – leisure and corporate ones. So we strongly believe that the combination of this recovery in the demand and some positive outputs coming out of the economic scenario can really pave the roads to better yields into further quarters. So it seems to be a kind of new trend.

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

Yeah. And just (21:23) on your question, Duane, there, on the leisure side, that's going to be helped by this reduction in Brazilian interest rates, which are now in single digits and kind of on their way to an 8% range, which is going to act as a positive stimulus on the market as a whole, but also disproportionately on the leisure segment also.

Q - Duane Pfennigwerth {BIO 7329167 <GO>}

Thank you. And then just for my second question, any early thoughts on fleet growth or ASK growth in 2018 and correspondingly thoughts on sort of the direction of you non-fuel cost structure? Thank you.

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

Yeah. Sure. On fleet growth, our plan is to basically grow at Brazilian GDP, and our current structure which is the combination of owned and leased aircraft basically allows us to vary fleet growth between 0% – or let's say ASK growth between 0% and 7% over the medium term. Next year, we plan to bump up by one aircraft to 121 by the end of the year and then to 124 by the end of 2019, but the ASK growth to come out of that in that plan, we expect to be about 3% per year on average over the next five years. And – but I think the important point, I think with our fleet plan today, we can kind of vary between 0% and 7% on ASK growth in terms of the flexibility you have with lessors and with Boeing on our order for 120 MAX, but our plan is to kind of follow GDP growth which we expect to be around 2% to 3%. So, that's what you should expect out of future ASK growth including next year.

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

Another important aspect when it touches the GOL's fleet plan is that we are much more focused in anticipating or accelerating the new technology to be implemented, I'm talking about the Boeing 737 MAX, then really increasing the fleet. So I believe – we strongly believe that by renewing our fleets bringing the Boeing 737 MAX as well as we can, we will be able to expand our market by reaching new destinations at the same time, but we will reduce fuel consumption considering that the new plane is really (23:53) more efficient than this Boeing 737-NG which is already best in this category.

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

In terms of – you're asking about non-fuel CASK, Duane, obviously, on the fuel side just to mention obviously we do expect significant increase in fuel cost next year based on expectations for combination of oil price and exchange rate. But on the non-fuel cost, the key driver is going to be – our work on the aircraft utilization side, as you saw, were up about 11 hours in Q2, which is their lowest quarter seasonally (24:32) if we take the month of July, we flew – which is the peak of the year, we flew across the 14 hours (24:38) utilization for that month in the peak season.

And that combined with the arrival of the MAX is going to – in July of next year, the first MAX is going to be a key driver on our ex-fuel CASK, everything else isolated and frozen out. So with that, in terms of our ability to drive increasing productivity with the MAX aircraft and high utilization, including the Brazilian inflation that we have to absorb which is in the order of 4% to 5% on the cost side on Brazilian inflation, at this point, we're looking at a 0% growth in ex-fuel CASK for next year, so basically offsetting the – the productivity gains are basically offset by Brazilian inflation for the most part.

Q - Duane Pfennigwerth {BIO 7329167 <GO>}

Thank you, guys.

Operator

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

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

Yeah. Hey, good afternoon, Kaki, Richard. Two questions here. One, as it relates to the appropriate level of cash relative to LTM sales, if we should push aside the accounts receivable and just look at sort of their most liquid form of cash and include the restricted cash as well, you were at 7% prior quarter, you're now at 9%. Where does that number need to be that gives you comfort? Is it 15%, does it have to be in the high-teens, can you talk about that?

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

Michael, we're obviously, as you know, analyzing (26:22) will have enough cash. That's what we all learned over the years, right? Also on credit side, yeah, the credit side, there's some methodologies on the credit side that kind of arbitrarily say that 20% is a good number. The issue with Brazil is we have a very high interest rate in Brazil, so very high cost of carry on that. And as we have a – as an airline, we're going to have a leveraged balance sheet. The good leverage is in dollars and the more expensive leverage in reais. With that said, we're working on – we're focused on getting our leverage first to roughly this 4 times financial leverage on a EBITDA basis by the end of the year, and we're on track to do that as you can see.

Beyond that, we'll be building with cash above that once we have – plan reducing the leverage below that because it's a good structural debt. So it's basically aircraft-related debt, and for us an aircraft debt is good debt. That's what produces our revenues. And so it's going to be slow going, kind of a very boring quarter-to-quarter improvement on cash. I mean we improve by almost BRL 200 million in the worse seasonal quarter of the year. We think that those changes in our operations, the network and our, let's call it, working capital and our CapEx, I mean the structural changes that we made. And so we think we can retain that kind of gradual increase in cash over the next couple of quarters, but – and so we don't have a target in terms of cash, the total revenues. No, we're going to target anything there. But operationally, we're at a cash level now that permits us to operate.

Another point that I was trying to highlight is we have other sources of liquidity, which we're currently not using, which are on the order of minimum BRL 500 million, which would put our cash balance at around 23% of total net revenues, if we were to execute those liquidity mechanisms, but they have an interest cost. And we'd like to keep that interest cost savings with our shareholders and not with the counterparties. So the way I define it, the way we manage the business today, we roughly have between 20% and 25% of total revenues in liquidity mechanisms, which is more than enough for us to run our business comfortably here going forward.

So the on-balance sheet cash, what you see how we define in terms of cash and accounts receivable and we keep those cash amounts and receivable so that we save on the interest cost, that's just going to show a gradual improvement over the next couple of quarters until we get to a point where we think about other uses for the cash other than just debt pay down. And so don't expect to see us doing anything drastic there. And part of it, as I said, is we're already at a number that internally – in terms of how we manage the business, we're already above a 20% number in terms of our total liquidity to have revenues, which meets all the cosmetic requirements that we have with things like the rating agencies or other indicators that we like to look at.

But going back to the first thing, I'd say we're always going to be looking at ways to increase cash because at some point it's going to take a while. At some point, ultimate target is going to end up being moving to return on capital mechanisms and cash to equity. And so the ultimate goal starts to get to basically having cash left over for equity, which in the short term next year will be building a cash cushion, and then maybe in the future – years from now, maybe never have some kind of distribution coming out to shareholders. But it's way too early to be talking about that. But we're on the right track. We still have some improvement to do.

But from a liquidity mechanism, being able to meet our operating and financial obligations were more than covered. And also as I mentioned, we have no significant short term – we have BRL 700 million of debt maturities over the next 12 (30:38) months, which is very comfortable position vis-à-vis our current cash generation. And finally, we're now in the next – the next three quarters are fairly good quarters for us. Q3 is a very good quarter, Q4 is a decent quarter as is Q1. And so from a cash flow perspective in terms of supply/demand, we're also looking at a pretty good stretcher over the next three quarters.

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

Okay. Good. And then – that's helpful, Rich. And then just another quick one on just the guidance. You do provide a per ADS and per local share range. Does that include the non-op FX charge, is that running through that because presumably given where the exchange rate is right now, we may see a complete reversal of that in the September quarter, so are you running that through or should we exclude that in getting to that range?

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

No. That's fully loaded. I mean that is reflecting what our – the time of that guidance that reflects what our assumptions were for fuel prices – for oil prices and exchange rate, so that's fully loaded including non-recurring. And it's important – and that's after the minority interest. And that's also designed to – we think that's a metric that we like the analysts in the market to use. So, we're going to be form that (32:08) helping people understand that. And like I just said, obviously, we have Q3, Q4, there is a – the exchange rate and what's going on with the Brazilian economy and so on, something (32:17) like we have a chance maybe to (32:22) the year. And so, that will take back a lot of that exchange rate variation. And as we said, we highlight the exchange rate variation, but it's non-cash. And I think in terms of how you look at it, you should work with that and eliminate it. But this includes all tax non-recurring and exchange rate effects.

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

Okay. No, that's helpful. Thanks for that. All right. Thanks, Rich. Thank, Kaki.

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

Thank you.

Operator

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

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

Hey, good afternoon. Just on the fleet side, is the plan still to (32:58) expand the seats to 186 and what the kind of latest update on that?

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

(33:07) 177 to 186. We have plan to replace to be exact 23 seat sets, those are the old ones and (33:23) compromising on comfort by brand new ones. So, we'll be able to expand the productivity and (33:31) seats per plane without compromising on comfort, as

I mentioned it before. We will start that process in the beginning of the next year, and we're supposed to ready by June-July next year.

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

Yeah (33:31) I mean, one of the reasons is that it's permitted is the reconfiguration of the interiors of the aircraft with leather seats which allows us to increase the configuration without changing the pitch. So we're still carrying the 34-inch pitch in the first part of the plane, and the rest of the plane also stays as it is. And so it's – that is one of the key configurations and then also just to kind of mention as well is that, together with that is the retrofit on the Wi-Fi in Brazil. GOL is the – basically the only company in Brazil that is retrofitting its aircraft with Wi-Fi. So all that's going to happening between now and the second half of next year, which allows us to, at the same time, reconfigure the entire fleet with the 186 including the NGs, which will then match the MAX-es that are already geared up to be coming out of the assembly line in Seattle in July of next year.

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

So (33:54) has two economy classes, the traditional one hanging from 30 to 30.5 inches. The GOL+Conforto 34 in the product growth, and all of them equipped with in-seat (33:54) leather seats and Wi-Fi.

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

Got it. All right. And actually touching on that, so just two questions on the demand – I appreciate the color on demand – one, is it an acceleration in demand that you're seeing into the second half? It sounds like it's definitely on the leisure side, I was curious on the business side as well. And two, just given the investment that you've made in kind of improving the quality of the product here and maybe some of your competitors going the other way, are you still seeing kind of your corporate share expanding here and how much more room do you think there is to go there?

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

As mentioned before, Savi, the corporate demand has recovered in lower pace than the leisure travels, but the trend is positive. It's pretty much related to the economic performance. And we do see in almost every segment among the business travelers a positive trend to the second quarter. It's still too early to measure it and to built into our guidance any kind of valuation (36:30) in comparison to what we have already delivered as a guidance, but the signs are quite positive.

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

Yeah, in our guidance, this is roughly 0% GDP growth through the end of the year, and that's our view. And as you know, the corporate demand in Brazil is little over 2 times elastic to GDP, so that will be the first to expand significantly to the extent we get some real GDP growth through the end of the year. And that's (37:06) highlight in terms of the guidance with – on the backend, fourth quarter specifically, that there is BRL 100 million to BRL 200 million there that relates to the economic side of the equation improving overall 0% or something for GDP growth. And that's not in the – that's not in the upside there, because we're not – the fact that we're (37:29) not seeing it yet in terms of the actual

GDP, obviously the expectations are that we will get perhaps as high as 2.5% GDP growth, those are expectations kind of from the research community and so on, but we're not seeing that yet at the Street level in terms of passenger demand.

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

Got it. And any thoughts on just kind of continuing to gain share because your product is kind of getting better and better especially compared to other competitors?

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

(38:02) in the corporate market, we have achieved our market share or a fair market share and we have only one-third of our fleet renewed offering such equipment as we mentioned before, the Wi-Fi and leather seats, so on so forth. Considering that we have simultaneously increased our NPS too and the business travelers are pretty much sensitive to that, but we believe that we can expand our market share in the corporate segment.

We are about to receive the final figures – or the second quarter figures from the ABRACORP and our expectation is really to lead in both aspects, revenue share and number of tickets sold, considering that the fleet is only one-third dedicated to these business travelers. Once they are highly appreciating the new equipments that we have built into our aircraft, I think then there is clear potential to increase this market share by having a larger business travelers preference (39:15).

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

We have the – in terms of the reconfiguration of the route network last year, we have the most attractive route network for business travelers. We dominate the main business airports and we have the highest punctuality. And those are key drivers of the business travel. And they want to – they want the frequencies and the punctuality, and that's basically our wheelhouse today in terms of how our aircraft will configure it on the network, we're – that's the main reason why we are number one in the market today.

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

Makes sense. All right. Thanks so much.

Operator

Our next question comes from Stephen Trent with Citi. Please go ahead.

Q - Stephen Trent {BIO 5581382 <GO>}

Good afternoon, gentlemen, and thanks very much for taking my questions. The first, I was just curious looking at the cash flow from ops in the quarter, they seemed to have come from three specific lines. I believe other assets, transportation commitments and interest expense on debt and leases, just trying to understand to what extent some of that was related to aircraft returns, and what specific adjustments occur it is that was (40:43) practically those were the three largest contributors.

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

Hi, Steve. The main source obviously is the operating EBITDA, EBITDA of around BRL 160 million was around half of the total net cash flow on the operating side. On the working capital side, we have worked to increase our average payment terms with suppliers, the partners in the GOL ecosystem, which allowed us to generate over another BRL 100 million of cash flow on a run rate basis. And then the final kind of major component was optimization of our CapEx specifically. And our aircraft (41:31) CapEx, we've been using the PDP financing mechanisms and sale leasebacks to reduce debt. And also have been working with our partners on the maintenance side, as we're still going through a lot of heavy maintenance, and so we're able to - we've been able to kind of optimize that. And so most of that kind of comes from the ecosystem, in terms of the actual cash effects, those are the main sources. (42:00) operational, and that was really driven by the increase in PRASK on the EBITDA side, plus a little bit on the aircraft utilization, and then optimization of the working capital CapEx. (42:12) the Q2 is from a cash flow perspective - obviously, seasonality was - is the lowest, but as we are looking at a pretty good Q3 in terms of volumes picking up, a pretty good July, you have those effects in there where the sales that happen in June are related to the transportation that's going to be happening in July, and that's why you see the effects on receivables and air traffic - the ATL, the air traffic liability, that really affects what's happening in July because the sales in June are going to basically produce the transportation in July. And July is the biggest travel month, first or second depending on what happens in January. But generally July is the big travel month for us in terms of the school vacations and the winter down here, and a lot of travelling is happening. And so those effects kind of going and then (43:12) also with what's been happening on the revenue side. But those are the main effects on that as I just highlighted.

Q - Stephen Trent {BIO 5581382 <GO>}

Okay. And I appreciate the color, Rich. And I was also curious when I think about what might be the long-term run rate and cash we're investing. So once you are out of the crisis in Brazil and we get back to normal level of expenditure and investment in the business, it's my guess that 2015 and 2016 are not the normalized levels, and any thoughts on what long-term run rate we should see annual investment in your fleet?

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

Well, right now, 2017-2018 is all - we're not going to have any on the aircraft side. And most of our investment right now is on - it's about - in that, roughly BRL 600 million of CapEx is happening, it's about two-thirds engine maintenance. We're basically zeroing out the engines in our portfolio. That will end next year and that will drop down kind of little bit next year and then get back to a more normalized level in 2019 on the engines side. The retrofit on the Wi-Fi which is the other third of that CapEx, that ends by mid-second semester of next year, so that also kind of phases out well.

So those - that number, that roughly BRL 600 million per year on that component, the more normalized level would be somewhere between BRL 200 million and BRL 300 million. As we got about 2 percentage points to 3 percentage points in there, which has happened over five-year period, of which we're now on year three - year three-and-a-half related to the upgrades on the Wi-Fi that retrofits the whole world fleet.

We mentioned there's a little bit in there for the retrofit on the leather seats on the aircraft and then the main component has been the engine maintenance. And there's no aircraft CapEx in there this year or next year because we did sale leasebacks and the PDPs. 2019, yes, we will start to get a portion of those aircraft coming in on the MAX order will be acquired, leased – probably leased 50% and that will start to show up in – with the PDP deposits and then eventually the finance leases.

In 2019, all the accounting in IFRS is going to shift to finance lease, meaning all the operating leases also are going to be accounted for as finance leases. In 2019, there's going to be some accounting changes, which will show – which will impact depreciation and so on. And so I kind of want to hold off, I'm giving more specific numbers for 2019 until we get a greater view on the accounting effects.

But those numbers are going to come down a bit. On the current CapEx, it's going to get cut more or less in half which means we'll have another BRL 300 million per year versus – positive versus what we've been spending today. And then in 2019, we'll start to phase in the acquisition CapEx on the aircraft. But it's not significant because we're going to have a gradual transition there. So, net-net, it's going to be reducing CapEx over the next few years, down to kind of like a BRL 300 million year (46:43) level and then 2020, it will start to ramp up again.

But also, I think importantly on the CapEx, over 80% of it, we finance with pretty low-cost financing sources, either with EXIM Bank guarantee or supplier financing that allows us to finance all of that CapEx, which is pretty much dollar CapEx at rates below 5% annual interest rates. And so, it really doesn't generate a big outflow on cash flow, and on the aircraft side, it creates equity value over the 12-year period that we do the aircraft mortgages. So that's actually a positive in terms of value creation. The aircraft acquisition activity for us has only created value over time.

We're just finishing now the first order that the company did, the 120 NGs, of which a portion of those were acquired. That cycle has terminated as of the last year and next year, we start the new cycle on the MAX order. And so we're pretty excited about getting back to that aircraft acquisition mode which creates equity value for shareholders over the long term.

Q - Stephen Trent {BIO 5581382 <GO>}

Okay. I appreciate that. I know time is going, so I'll let someone else ask a question. Thank you.

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

Thank you.

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

Thank you.

Operator

Excuse me, this concludes today's question-and-answer session. I would like to invite Mr. Kakinoff to proceed with his closing remarks. Please go ahead, sir.

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

Okay, ladies and gentlemen, I hope you've found our presentation and the Q&A session helpful. Our Investor Relations team is available to speak with you as needed. So thank you all very much.

Operator

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