Q4 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

- Catherine M. O'Brien, Analyst
- Dan J. McKenzie, Analyst
- Duane Pfennigwerth, Analyst
- Matt Roberts, Analyst
- Petr Grishchenko, Analyst
- Victor Mizusaki, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Welcome to GOL Airlines Fourth 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 the 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-looking 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 morning, ladies and gentlemen, and welcome to GOL Airlines fourth quarter 2017 conference call. I am Paulo Kakinoff, Chief Executive Officer; and I am joined by Richard Lark, our Chief Financial Officer; and (00:02:22), Treasurer.

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

Good morning. Good morning, everybody.

Paulo Sergio Kakinoff {BIO 5160310 <GO>}

This morning we released our Q4 figures. Also, we made available on GOL's Investor Relations website three videos (00:02:36) presentation, financial review and brief Q&A. We thought this allows you a better understanding of our quarterly results at the moment we disclose our earnings release. Also, this formally (00:02:50) will give us much more time with the conference call for questions and answers.

From the beginning I would like to highlight that we have significantly improved all indicators in the fourth quarter 2017. GOL's RPKs increased by 8% from 9.2 billion in the fourth quarter 2016 to 9.9 billion in the fourth quarter 2017, mainly due to a 6.2% increase in the number of passengers. GOL achieved this strong growth in demand despite its continued focus on pricing. Average yield per passenger increased by 3.1% in the quarter compared to fourth quarter 2016, reaching BRL 0.2636.

Supply growth remained conservative, with ASKs increasing 3.5% compared to the Q4 2016, driven by a 1.6% increase in take-offs and a 1.8% stage-length expansion. As a result, the average load factor in the fourth quarter grew 3.4 percentage points compared to the same period in 2016, reaching 81%.

For full year 2017, RPKs increased by 3.6%, primarily due to a 4.8% higher stage-length, with yields growing by 2.2%; ASKs increased by only 0.8%. Load factor was 79.7%, 2.2 percentage points increase compared to 2016.

GOL remained the industry leader in flight punctuality, with 92.5% of flights on-time in fourth quarter and 94.6% in 2017 according to Infraero.

We continue to have strong revenue growth. The combination of higher demand and improved pricing resulted in net revenue for the quarter of BRL 3 billion, an increase of 11.8% quarter-over-quarter. For full-year 2017 the figure was BRL 10.6 billion, 7.2% higher than the prior year. GOL's current 2018 guidance is for net revenue of approximately BRL 11 billion.

Our network serves higher-yielding routes and has a leading share in the Corporate Finance (00:05:18) segment. We have currently the largest share of business traffic in the country, and we are optimistic about our prospect as the economy and business demand continues to strengthen.

We also remain committed to providing the best overall air travel experience. We designed our air network to provide integration and interconnectivity, as well as offer the largest number of flights in the main business destinations. This January, we started selling tickets for GOL's four routes between Brazil and United States from Brasília and Fortaleza to Miami and Orlando.

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

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

Thanks, Kaki. First, we like to comment about our controlled cost environment. Total CASK in the quarter was BRL 0.2121, just 1.4% higher than the same period of 2016, in spite of a less benign fuel environment. GOL remains the cost leader in South America for the 17th consecutive year. And our margins continue to expand. GOL's EBIT margin continued to expand, reaching 13% in the fourth quarter of 2017, which is the highest fourth-quarter indicator since 2011 and a 5.6 percentage points improvement over the same period in 2016.

Operating income, EBIT in 4Q 2017 was BRL 388 million, an increase of 96% quarter-over-quarter. For the full year 2017, EBIT margin was 9.4%, which was a growth of 2.3 percentage points compared to 2016, and operating income reached BRL 1 billion. GOL's current 2018 guidance is for an EBIT margin of approximately 11%.

EBITDA margin was 17.8% in 4Q 2017 and 14.1% in 2017, a growth of 5.8 percentage points quarter-over-quarter and 2.5 percentage points year-over-year. EBITDAR margin was 25.5% in 4Q 2017 and 23% in 2017, an increase of 9 percentage points quarter-over-quarter and 1.3 percentage points year-over-year.

Operating cash flow generation was strongly positive by BRL 630 million with a record operating cash flow margin of 21%, our highest since 2011. And for the full year 2017, GOL had an operating cash flow of BRL 1.7 billion with a 16% operating cash flow margin.

On page 11 of our press release, we provided a summary of operating cash flow, which helps you all reconcile that from the financial statements where there are two major adjustments. One is that in the financial statements from an auditing perspective, investments and financial investments in (00:08:27) cash securities are out of the operating cash flow that needs to be added back. And also, as you know, GOL is in the final phase of heavy engine overhauls, which are capitalized. And those are excluded from suppliers payable and put into the net investment line or the CapEx line where we had approximately BRL 362 million in the fourth quarter of 2017. And so, that reconciliation is provided for you on page 11 of the company's press release.

And to finalize this brief review, we wanted to share the highlights of our balance sheet strengthening. The net debt, excluding perpetual bonds, to last 12 months EBITDA was 3.0 times in 4Q 2017, improving both versus the 3Q 2017, where it was 3.4 times and the 4Q 2016, when it was 4.2 times. Total liquidity, including cash, financial investments, restricted cash and accounts receivable, totaled BRL 3.2 billion, which is an increase of 51% versus September 2017 and an increase of 66% versus December 2016.

The combination of GOL's credit rating upgrades, successful notes offering, 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, GOL subsidiary, GOL Finance, priced an additional issue, a re-tap offering, in the amount of $150 million of its Senior Notes due 2025, with a coupon of 7% per year.

Regarding guidance, we expect to close 2018 with 1% to 3% growth in domestic ASKs over 2017. We projected load factor of 79% to 80% and ex-fuel CASK of around BRL 0.15. EBITDA and EBITDA margins in 2018 are expected to be around 16% and 11%, respectively. Earnings per share are expected to be between BRL 1.20 and BRL 1.40. Earnings per ADS are expected to be between $0.75 and $0.90.

For 2019, on a preliminary basis, we expect domestic capacity growth to be between 1% to 3% and non-fuel CASK to remain stable in relation to 2018. EBITDA margin is expected to be around 18% and leverage is expected to be approximately 2.5 times.

Now, I'd like to return the mic over to Kakinoff.

Paulo Sergio Kakinoff {BIO 5160310 <GO>}

Thanks, Rich. We expect to continue to drive our efficiency and technology advantage this year. We're configuring our Boeing 737-800 NGs from 177 seats and 186 seats, as well as incorporating the new Boeing 737 MAX 8 in the second half of 2018. With a range up to 6,500 kilometers, the new Boeing 737 MAX 8 aircraft will allow GOL to offer non-stop flights from Brazil to any destination in Latin America, as well as to our recently announced destinations in Florida.

We remain focused on offering the best experience in air transportation, providing exclusive services to our customers on new, modern aircraft that connect our main markets with the most convenient schedules. Over 100 aircrafts in our fleet have already been retrofitted with eco-leather seats, and more than 80 have on-board Wi-Fi and live TV. Our entertainment platform is the most complete and modern in Latin America and also offers a free entertainment catalog. We also offer our customers selfie check-in, GOL+Conforto seats, and an expanded menu of on-board products, while remaining a low-fare leader.

To conclude, I would like to mention again that we made available on GOL's Investor Relations website three videos (00:12:44) presentation, financial review and brief Q&A, as well as the full presentation and the earnings release. Along this day, we would highly appreciate (00:12:56). We hope this will provide a better understanding of our quarterly results. In addition, this format will give us much more time on the company's call for the questions and answers. And we start at this moment.

Q&A

Operator

Thank you. The floor is now open for questions. The first question comes from Michael Linenberg of Deutsche Bank. Please go ahead.

Q - Catherine M. O'Brien

Good morning, gentlemen. It's actually Catherine O'Brien filling in for Mike. So thank you for sharing that 2018 and 2019 operating margin guidance. Very helpful to put some context around what you're seeing over the next couple years. But can you talk about if we should view 2019's 13% operating margin as a normalized level? Are you expecting to see further improvement in there? Any color on your view what GOL's average margin should be over the cycle will be really helpful. Thank you.

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

Yeah. Hi. Good morning. Well, the numbers we gave you, I mean, that's management guidance. You can use that as you see fit, but that's based on what we see. I'm not sure if I understood your question, but in terms of average and so on, but the company has recovered substantially its margins, 2017, as you can see, and we gave you guidance for 2018, and that reflects basically what we see in terms of the combination of what we're planning on doing with our network specifically.

Keep in mind, in 2019, we also start to get a larger portion of our fleet with the Boeing 737 MAX 8s, okay? They start coming in in July of this year, but it's a timid (00:15:04) impact. But the MAX 8 for us, our figures is kind of like a double whammy for our economics. We get about a 3% or 4% annual cost reduction as we feather that into our fleet on the cost side, mainly deriving out of the lower fuel consumption on the MAX, 15% lower fuel consumption. But also we get greater revenue productivity.

So we also get a hit above the line, if you will, on the revenue side, not just on costs, but also on revenues, because of the greater productivity of the MAX, not just in terms of a larger seat configuration, but also in terms of what we expect in utilization, increase in average stage-lengths. As you know, the MAX, in addition to the 15% fuel economy on the cost side, it also has an average stage-length of another 1,000 kilometers, which allows us to increase revenues and is a key driver for us being able to add the Florida and international destinations that we're adding.

So it's a combination of those factors that - in addition to what we expect in terms of the overall macroeconomic environment, it's really behind those numbers that we're providing to you on guidance. But that's based on what we can see into the future at this point.

Q - Catherine M. O'Brien

Okay. Understood. Thanks a lot (00:16:27). I just meant like, are you thinking that 13% is peak margins, or do you think kind of next 5, 10 years you're going to average something more like 15% or just kind of how you think about that longer term?

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

Yeah, we haven't provided any guidance on what peak margin would be. I think probably what you could do there given your guys' experience in the U.S. market and understanding of airline economics, kind of model that. In Brazil, we have a high concentration of business travelers, and in our network we have an even higher concentration. We're the number one business airline in Brazil. So that gives us a relatively higher yielding traffic, but on top of the very same aircraft that you see, companies like Southwest and Ryanair operating. You guys know those economics of Southwest and Ryanair very well.

And I think on the revenue side, I would just add, is Brazil, and especially in our network and our business, we have a very high component on the business travel, the corporate travel, which is a higher yielding travel course (00:17:34). But the key driver – what I was just trying to say is that the key driver for us, and this is really the competitive advantage for GOL, is what we're doing with the MAX aircraft. But, I mean, you know that you have now 17 years of history of GOL to kind of see where margins could go. Obviously, a key driver of that is also going to be solid capacity management. But that's what I would add in terms of contextualizing that.

Q - Catherine M. O'Brien

Understood. Thanks. If I can just sneak one more quick one in. For your new service in Orlando and Miami, are you able to schedule those flights in a way to create connection opportunities with Delta to other U.S. destinations?

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

Yeah, of course, I mean, that's part of the partnership that GOL has with Delta is to – not just on the Brazil side in Guarulhos and Galeão and the airports in Brazil, but also on the U.S. side to do connections with Delta through our partnership with them.

Q - Catherine M. O'Brien

Okay. Thank you for the time.

Operator

The next question comes from Duane Pfennigwerth of Evercore ISI. Please go ahead.

Q - Duane Pfennigwerth {BIO 7329167 <GO>}

Hey. Thanks. Good morning. On the 2018 capacity guidance, it's actually a bit less than what we were thinking. We were thinking more mid-singles, and it could just be that we were off base. But has your 2018 capacity planning changed at all? Has it moderated a little bit? And then, can you give us any sense for the cadence of that by quarter?

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

Yeah, I think...

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

Hi, Duane...

(00:19:05)

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

Go ahead, (00:19:08).

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

This is not to (00:19:12) mention that we have developed in a quite flexible way to adjust capacity into a year whenever we do see either an opportunity to increase yields sustaining higher load factor level or adding capacity whenever we see a stronger demand than expected.

So at the moment, we have been quite conservative regarding that because we do not know exactly how the second half of the year will behave with regard the election period in the year and the political volatility and coincidentally, if possible, instability due to political speculations.

So what we have in so far is a strong demand in the first quarter of the year. Our short-, medium-term forward bookings are also pretty positive, but the other company has played a major role in keeping or influencing the capacity discipline being a company as big as GOL is today. So we think that we have the right tools to quickly react whenever we see further opportunities regarding ASKs. But at the moment, we believe that we should play a more conservative game.

Richard, would you like to add something on this?

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

Yeah. Duane, I'd just add to that is that our plan is to grow domestic capacity, GDP. And so, we're still filling out the demand side of the equation. We have the ability to increase that because we operate with a couple of aircraft and subleasing that we can manage to bring back some additional capacity to capture additional upside on demand. And also, as we bring in the MAX to our fleet, we have the ability to adjust capacity on the rest of the fleet via (00:21:14) the configuration. And so, we have a pretty good mechanisms on the upside to kind of manage that as we kind of fill in demand (00:21:27).

Now, in terms of the quarterly, we're not providing quarter guidance on capacity, but we're going to be getting five additional aircraft in our fleet starting in July. They're all being dedicated to these flights from Fortaleza and Brasília to South Florida. So they're in the international bucket, are not going to be in the demand bucket. And so, that's what I would comment on that.

Q - Duane Pfennigwerth {BIO 7329167 <GO>}

That's great. And then, as you analyze these international markets and Florida specifically and you look at the prevailing fares, and of course, it's going to adjust to these capacity changes, but what the fares look like on those routes today? What would you expect yields to look like on those routes relative to your system averages today?

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

That is, I mean, I'd say, promising at the moment. Despite the fact that we have a huge addition now in the national routes, we got in ASKs and they are bulking on the (00:22:32) industry, not GOL only. The market is reacting quite positively. And the main reason for that is that basically what the (00:22:48) the capacity cut in 2015 and 2016 due to the Brazilian real devaluation. So at the moment, we believe that the current strength of adding two digits capacity on the international routes will be kept for 2018 and 2009 (sic) [2019] (00:23:18) and it seems to be a quite positive movement regarding routes.

Q - Duane Pfennigwerth {BIO 7329167 <GO>}

Thank you.

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

Thank you very much.

Operator

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

Q - Matt Roberts {BIO 20272688 <GO>}

Good morning, gentlemen. This is Matt Roberts on for Savi. I apologize if I missed this, Richard, in the prepared remarks, but could you describe again what really drove the low maintenance per ASK value in 2017? Is that the right level going forward? And then just additional color on that one-time item from the 4Q 2016 rent per ASK? Again, sorry if I missed that earlier.

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

Yeah, GOL's fleet returns ended in April 2017. So in the 4Q of 2016, there were higher maintenance expenses per ASK based on aircraft returns, and those were not present in the 4Q of 2017. So that's where you see the irrelative reduction in the quarter-over-quarter period.

Q - Matt Roberts {BIO 20272688 <GO>}

Okay. Great. Thanks for the clarification there. And then turning again over to your 2019 guidance, given that there's a nice step up in capacity growth in 2019, it's somewhat surprising that your non-fuel CASK is expected to be flat. So is that a function of higher costs going into more international markets, or if you could just provide some additional color into your thinking there, that would be great? Thanks.

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

Well, if I understand your question, I mean, the Boeing 737 MAX 8 creates large cost reductions for GOL. Not only do we have the 15% fuel economy, we also have greater revenue productivity via the higher stage-length. And so, that's pretty much what's driving the revenue growth with stable CASK in there. I don't know if that was your question, but that's how I would answer.

Q - Matt Roberts {BIO 20272688 <GO>}

Yeah, it wasn't the question. I was just saying that the capacity growth is stepping up from 2018 to 2019. I thought maybe there would be some additional scale with the growth there that could reduce CASK. Is that not the case?

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

Well, no. I mean, the domestic capacity growth is growing pretty much the same rate. The larger growth in capacity you're seeing overall is being driven by the international component of that. That start to have a larger component of the business.

As we bring in the Boeing 737 8 MAX (sic) [Boeing 737 MAX 8] (00:25:49), we're going to be going from around 15% of our total revenues today outside of Brazil domestic to a little over 20%. And so, if that comes in, yes, there is going to be a stage-length effect in there, slightly longer stage-length effect. 1,000 kilometers on that 20% of the network that's being done in international flights. But that's in that non-fuel cost guidance that we've provided. It's in those numbers.

Q - Matt Roberts {BIO 20272688 <GO>}

Okay. Thank you.

Operator

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

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

Oh, hey. Good morning. Thanks, guys. Hey, Richard, I'll just follow-up on that last question. I wonder if you can just provide some perspective on the relative profitability of the international overall versus domestic. Is the international flying, is that opportunity? Should we think of that as our higher-margin opportunity versus domestic? I was just wondering if you can help us understand kind of the dynamic on that part of the network.

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

Yeah. Sure. The domestic Brazil business has higher margins than the international long haul. But our main international today is South America, right, and so, Argentina and Southern Cone, and that part. We're going to be adding with the MAX out of Fortaleza and Brasília flights up to South Florida. The relative profitability on those flights on an isolated basis is lower than the profit that we get on our domestic network.

You know my work (00:27:28), the largest domestic carrier with the best position and the best markets, and that just kind of put us in a position to be the number one business airline. Taking up last year, we even passed competition in the top of mind category. And so, we're dealing with very high-yielding traffic in Brazil. It's not to say that the international traffic is also not profitable, but it has a lower profitability than our pure domestic traffic in our network, speaking just (00:28:00) about our network specifically.

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

Okay.

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

I'm not talking generally about the market. I'm talking specifically about our other goal network.

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

Yeah. Understood. And then, I guess, just with respect to your comment on business travel, I wonder if you can just elaborate a little bit further on that because what we've seen over the past year is political volatility that it has driven foreign exchange volatility, but the business travel trends seem to have held pretty steady. And I'm just wondering if there's some additional sort of thoughts that you could share as we think about 2018, 2019? What are the key drivers and kind of what are you seeing across your network?

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

Yeah, I'll start and I'll flip over to Kakinoff to finish it. The key driver of domestic demand in this recovery, obviously is, first, the corporate travel. And I would say since October or so of last year we're seeing the domestic demand more or less track the GDP expansion. We're seeing kind of the domestic demand kind of - since then in the rough, kind of the 5% growth rate overall.

With that, I'll ask Kaki to complement that.

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

It is the first time we have in Brazil inside the cage. The very benign combination, I would say, positive GDP, a very low inflation rate for Brazilian standards, the level of 4% to 5% and also our low crime rate. So that created this benign environment not only towards the airlines, but to every business in Brazil. So that's the main reason why the business demand is growing so fast.

And in complement to that, it's important to notice that GOL is offering at this moment the best products to the specific market segment. We have the largest network. We are really on the edge among the top 10 business airports in Brazil. We have the largest number of frequencies in our country, and the product has some unbeatable experience that's being offered, such as more (00:30:34) to economy classes, leather seats, Wi-Fi onboard, selfie check-in and the combination of free meals and live TV onboard.

So we are not only making the most out of this benign environment, but also we have included all the market share among the corporate drivers. This is just because we have been able to accept those customers from the competition to fly with ourselves. That's the reason that we are pretty much confident in our capacity of even increasing further our market share among these customers.

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

Very good. Thank you. And if I can just squeeze one more in, and that's just tied to foreign exchange or FX sensitivity for 2018. I'm wondering what the FX sensitivity is for this year, just holding all else constant. And then just, I'm wondering if you can share what the FX parameters are, you're factoring in for kind of the high end or low end of year 2019 outlook? All else equal, at what point would you begin to worry about missing the lower end of that 2019 outlook, just looking at FX alone?

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

Yeah, we, I mean, looking at FX, it's not - I mean, we don't think like that. So I'd have to actually come up with kind of an alternative universe. I mean, in our business we have a combination of oil prices and FX working together and that's how we manage the business. And so, you necessarily have to have an assumption on oil to calculate the FX numbers also.

We're assuming that the correlations will continue to work together. We have almost a perfect negative correlation between oil prices and Brazilian local currency. Yes, we probably have - we expect the currency to be bouncing (00:32:39) around at the current levels where we are right now through the rest of the year and that's reflected in the guidance that we've provided you. And we start with fuel and we kind of - we're working with fuel kind of working between $56 to $63, bouncing around in that level or in kind of - the most of this year at the higher end of that range, closer to the $63.

So I think with what I just said there you should be able to figure out kind of what our view is. Having said that, if the correlations were to hold statistically, we should see a real at or below BRL 3 by the end of this year if we continue with oil prices in the low 60s. You should see a Brazilian currency in the low 3s or even perhaps as low as BRL 2.95 (00:33:32) by the end of the year if the historical correlations between oil and currency hold.

Having said that, we expect oil to continue at this current level kind of through this year and currency kind of be bouncing around at the level that it is right now. That's kind of what's reflected (00:33:50) that we're sharing with you. But if you would use the statistics like I said, you should probably see real closer to the BRL 3 (00:33:58) level, plus or minus.

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

Yeah. Thanks for the time, guys. That's very helpful.

Operator

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

Q - Petr Grishchenko {BIO 19084897 <GO>}

Good morning, gentlemen. Congrats on the quarter. Just got a few questions. I wanted to follow-up on the ASK guidance, international segment specifically. The 7%, 10% (00:34:21) increase in this year, this assumes just kind of fourth quarter ramp up in the Miami and Orlando routes and specifically next year, 34% increase. Does that assume additional routes or just kind of full ramp of the Florida routes?

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

Hi there. Good morning. Thank you very much for the question. Actually, the combination of both. So we are ramping up the ASK (00:34:49) international routes basically this year on the third quarter because that's the time when we are going to have six Boeing 737 MAX delivered and operated. So you know that we are expanding our international routes, making the most out of such capable new equipment like the Boeing 737 MAX. It can reach 6,500 kilometers range, which gives us the opportunity to further expand our network by adding new destinations.

So far we have announced that Miami and Orlando, but for 2019, we are going to have new destinations being add. Considering the current international network being operated, the new aircraft has nine seats more than the Boeing 737 current NG. You know that they're going to reconfigure the next generation (00:35:54) and then, the Boeing 737 NG and Boeing 737 MAX will deploy the same 186 seats, which automatically adds on our current international routes some ASK additional effect.

So in summary, that's a combination of both. We'll have more ASKs available on the current international network. We will have the Boeing 737 MAX (00:36:32) the opportunity to fly to new destinations. That's the reason why we are forecasting such a big ASK capacity increase on the international routes, mainly in 2019 (00:36:47) going to have a much bigger number of Boeing 737 MAX being already delivered. You know that our delivery pattern from 2019 on will be around 8 to 10 Boeing 737 MAX being incorporated to our fleet.

Q - Petr Grishchenko {BIO 19084897 <GO>}

Got it. And I guess I just want to follow-up on the aircraft rent. Seems like you add what, like, six aircraft this year, and why the (00:37:20) changed?

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

(00:37:25) I mean last year we had - you had, I mean, keep repeating this fact. I mean, in 2016 GOL reduced its fleet by 29 aircrafts and those aircrafts were returned all the way into April of 2017, okay? And so, there are additional costs in and those aircrafts were taken out of operations in May of 2016.

And so, the revenues being generated were on the new fleet size, but they still continue in the cost side and were gradually phased out through April of 2017, okay? And so April 2017, the company has been operating in this new operating level fleet, but the company had those aircraft grounded, was paying costs on those aircraft, and also had additional costs related to the early return of those aircrafts. And that affected the income statement all the way through April of 2017.

So both on the rent side as well on the maintenance side those impacted higher levels operationally and efficiency if you will. Efficiency on the aircraft rent side per ASK and on a total basis in the 2016 numbers and in 2017 all the way through April. So it's a much lower efficiency that the company was operating at just given that it had this massive amount of aircraft in the return process as of April. As of May 2016, those aircrafts were out of the revenues and as of April of 2017, those aircrafts are entirely out of the cost side of the income statement.

Q - Petr Grishchenko {BIO 19084897 <GO>}

Okay. Got it. And then just last question, just want to also want to follow-up on the fuel pricing. I see you assume I think around 5% increase in fuel prices this year. And I'm just looking at the benchmark. I think it's up like over 20% so far this year. And I'm wondering, does this include hedges? And if so, maybe you can elaborate on volumes hedged and prices as well.

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

I mean, in Brazil, I mean, you're probably looking at - I don't know if you're looking at international oil prices. You have to remember that in Brazil, our jet fuel is denominated in reals, and there's a specific mechanism of pricing of fuel with Petrobras. So basically, once a month, there is a formula, which updates the fuel prices, which is based on the average JET 54 for the previous month and the average exchange rate. And so, both of those elements work together to determine our fuel price in reals per liter.

And so, I mean, you have to have - as I was saying on Dan's question, to understand that, you have to have a view on both oil and on currency to project the fuel price per liter. But the numbers we're providing, you guys basically reflect our views on both of those. And we also have less volatility in Brazil on jet fuel, because once a month the fuel price is reset based on the previous months' JET 54 and exchange rates and that's the price for the next 30 days. So on fuel, we have 12 prices throughout the year.

And so this is kind of how it works in Brazil. So we have less volatility, more predictability of the fuel, and we have higher taxes in Brazil than you see in international markets, higher fuel taxes. We do have the benefit of a more stable, foreseeable pricing mechanism. So we spend a lot of our time forecasting oil prices in our risk management strategy and obviously also on currency. But those numbers that you see there are basically what we are working with this year in terms of our budget and (00:41:32) to reflect upon.

But international oil prices and currencies are extremely transparent. And so, you can put your own assumptions in there and play around with what you think – what you guys might speculate against this guidance in terms of what your views are on oil and on currency (00:41:53) I think the currency side is easier. The harder is the oil side. So we spend a lot of time on the oil side and then we work a lot with statistics and correlations on that. But that's basically the numbers you see there that we're providing to you guys are easy to speculate against because, I guess, you guys have a lot of knowledge on oil prices and currency. But that's basically what we're working with in our process. And I've given you guys some visibility on that.

Q - Petr Grishchenko {BIO 19084897 <GO>}

Great. Thanks a lot for the color. And just I want to squeeze the last question. Just using your own guidance, I mean, you guys should be generating some cash this year, right? And the net leverage because you show is roughly unchanged. So I was just wondering, is that like what...

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

Yeah, that's a good question. I mean, the way that works (00:42:46) is that we have a positive operating cash flow, neutral working capital. With our margin guidance, (00:42:56) we basically have neutralized the effects of working capital. And our CapEx is fully financeable. So part of that will depend on if we decide to fully finance the CapEx, which is mainly engine overhauls and the finalization of Wi-Fi and interior retrofits.

But based on our assumptions, we expect to have some operating cash flow to continue to reduce leverage. And so, you're correct that number of 3 times there, but the run rate we should be at the end of the year should definitely be in the 2.5 (00:43:39) range, maybe not on a full-year basis, but because we're still carrying a little bit in the first quarter of this year. But by the end of the year, we should be closer to that 2.5 (00:43:49) number.

And part of that will depend on the timing of what we do with amortizing our local currency debentures. As I was mentioning, our plan is to fully amortize those when they come due. The next maturity is in October of this year. Then there's another maturity on October of next year. So part of it depends on if we follow through on that, on amortizing the debentures or not (00:44:11). If we do amortize the debentures, the debentures of the operating cash flow, yeah, by the end of this year we should be closer to that 2.5 (00:44:19) level that we've guided you guys on 2019.

Q - Petr Grishchenko {BIO 19084897 <GO>}

Understood. Got it. Thanks so much for the color, and best of luck to you, guys.

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

Okay. Thanks.

Operator

The next question comes from Victor Mizusaki of Bradesco BBI. Please go ahead.

Q - Victor Mizusaki {BIO 4087162 <GO>}

Hi. I have two questions. The first one, I wanted to take a look on your guidance for ancillary revenues. (00:44:52) 14.5% to almost 17% of total revenues. So I don't know if you can give any color on what would drive this growth. And the second one, when we take a look on your guidance and see effective tax rate, the guidance is zero for 2018 and 2019. Is this just for GOL or the consolidated company?

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

Well, Victor, you should know that this is consolidated guidance. Could you repeat the first question?

Q - Victor Mizusaki {BIO 4087162 <GO>}

Yeah. Because ancillary revenues as percentage of total revenues will increase, right? So for this year we talk about 14.5% and it will reach 17% of total revenues by 2019. So is this something related to, let's say, Smiles or there's some benefit from the fleet consignment (00:45:44) revenues? So I don't know if you can explain a little bit more what the percentage was.

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

if I understand the question you're asking about the cargo and other revenues, Is that what you're asking?

Q - Victor Mizusaki {BIO 4087162 <GO>}

Yes. Yes.

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

So you're trying to back into the Smiles revenues or something. Well, I think I mean, Smiles has provided some guidance on their revenues. So you can kind of figure out that piece from the guidance that they are providing. As you know, we've also developed some other additional revenue sources on other revenues that were not in the full year last year.

For example, first bag fees (00:46:26) as well as – the cargo business is growing at double-digit rates low in the teens. And so, a combination of those two factors plus what Smiles is doing is allowing us to increase the revenues there. But I'll leave it up to you, guys, to figure out if you want round that down or up on that. I mean, we're giving you guys a little bit of a peek in the future there, but you'll have to figure out how much you want to go down or up on that BRL 2 (00:47:00) billion number there. I'll leave that up to you guys for the time being.

Q - Victor Mizusaki {BIO 4087162 <GO>}

Okay. And the effective tax rate zero-ish for the group, right?

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

Say that again?

Q - Victor Mizusaki {BIO 4087162 <GO>}

The fact it fluctuates for 2018 or 2019 that you are guiding zero, is this for the group or for the airline business?

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

It's on the tax business. Okay. I'm sorry. I didn't understand your question. Again, all these numbers are consolidated, all right? And so, what we're trying – this was a request of many of you, have requested help on understanding the tax, how to understand taxes at GOL, okay? And obviously, you know that Smiles is a full-tax payer and GOL has billion dollars of NOLs. But it's a combination of factors, yes. This reflects what on a group basis, includes what Smiles is paying, and it also includes the effects of the tax credits that exist on the GOL side.

Now, as you saw in the fourth quarter results, GOL is now starting on – effectively, if you want reversions of recognitions of the tax credits it already has on the balance sheet that had been impaired, they were impaired in recent years because of the business plan not justifying the full utilization. So it basically wrote off over a period of time, wrote off about BRL 1 billion of tax credits. And so, it's a combination of those.

So you guys have asked for some help on the taxes. And what I'm just providing here is that. I'm just saying the effective group tax rate in terms of when you guys are looking at how you're going to be doing your modeling for earnings purposes is zero. You were saying you can use that number this year and next year and that's the purpose of providing this (00:49:05) based on a request to help understand.

A part of it is the complexity is that one-time we have carved out (00:49:12) that is a full-tax payer, 34% income tax. And we have another business, which is the airline, which has a BRL 1 billion NOL, which doesn't pay any taxes, and in fact, creates deferred tax income. So those two are basically offsetting (00:49:32) just a general guidance for you guys that want to think about that, and for those of you that are working on earnings projections. That was the purpose of providing that. Sorry. I didn't understand the question when you first asked it.

Q - Victor Mizusaki {BIO 4087162 <GO>}

Okay. 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 find our presentation and Q&A session helpful. Our Investor Relations team is available to speak with you as needed. So, thank you very much.

Operator

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