Q3 2006 Earnings Call

Company Participants

- Constantino De Oliveira, President and CEO
- Richard Lark, Executive VP and CFO

Other Participants

- Bob Mcadoo, Analyst
- Christine Min, Analyst
- David Strine, Analyst
- Jim Parker, Analyst
- Mike Linenberg, Analyst
- Rodrigo Goes, Analyst
- Stephen Trent, Analyst
- Travis Anderson, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. At this time we would like to welcome everyone to GOL Airlines Third Quarter 2006 results conference call. Today with us we have Mr. Constantino de Oliveira Junior, President & CEO and Mr. Richard Lark, Executive Vice President and CFO.

We would like to inform you that this event is recorded and all participants will be in a listen-only mode during the company's presentation. (Operator Instructions) Today's live webcast, including both audio and slide show, may be accessed through GOL's website at www.voegol.com.br/ir. The slide show presented by management today is available on the website in the investor relations section.

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

Now I'll turn the conference over to the CEO, Mr. Oliveira, who will begin the presentation. Mr. Oliveira you may begin your conference.

Constantino De Oliveira {BIO 3888521 <GO>}

Thank you. Good morning. First of all I would like to welcome you to GOL's Third Quarter 2006 results conference call. In this quarter we reaffirm our principal cycles that you can see on slide number 2. GOL was founded nearly over five years' ago to popularize air travel in Brazil and South America. And 2006 has been a record year for growth.

Over the last two years our steady increase in low fares (inaudible) secular growth in market demand resulting in the high load factors for growth. The (healthy) (mechanics) of this (inaudible) cycle has permitted us to offer new products for different customer segments such as (inaudible) payment programs on our night flights as well as increasing our offering of more seats at low fares.

In the first nine months of 2006 almost 13 million passengers chose to fly GOL and we experienced a 52% increase in our (domestic) demand as measured in RPKs over the same period in 2005 helping drive industry average growth to 15% during the year. The increase in available seats has allowed us to push and stimulate demand among existing air travelers as well as attract new customers. Over 10% of our customers traveled by air for the first time on GOL.

Fixing focus on our (inaudible) cycle has been a key factor for our growth and for creating the necessary conditions for the popularization of air travel in Brazil and South America.

Please move to slide number 3 entitled Highlights. The Third Quarter of '06 represented another (period) of profitable growth for GOL. Our net income in the Third Quarter was a record of R$190 million in US GAAP. (inaudible) the case by our 24% pre-tax income margin sustained by our (inaudible) low cost (inaudible) management.

GOL is the lowest cost provider in the Brazilian air market and is a global leader in terms of growth and profitability. GOL remains committed to providing high quality passenger transportation service and (inaudible) to create and stimulate demand was (inaudible). In the Third Quarter of '06 the addition of new aircraft to the fleet represents about 46% expansion in capacity and that the addition of 78 new daily flight (inaudible). Higher capacity and our 5.1percentage point increase in load factors to 78.8% contributed to our 56% year-over-year growth in RPKs resulting in a higher domestic market share which makes it approximately 36% at the end of Third Quarter '06.

We are focused on continuing to reduce our costs so we can offer lower fixed tariffs and continue to increase demand for our services.

Slide number 4 shows the recent additions to our fleet and base network. We added five 737 800s in the Third Quarter and (returned) one 737 300 ending the quarter with a fleet of 64 aircraft. We plan to finish the Fourth Quarter with 65 737 aircraft in the fleet. And we plan to expand our network with new markets in Brazil and South America and with additional flight frequencies supported by our fleet expansion of new Boeing 737 800 engines.

During the Third Quarter we added three new destinations bringing our total number of aircraft services to 63 ahead of plan.

I would now turn the call over to our CFO, Richard Lark, who will discuss financials and operating performance for the quarter in more detail. Please Richard.

Richard Lark {BIO 3484643 <GO>}

Thanks (inaudible). Good morning everyone. Please move to slide number 5 in the webcast presentation. On this slide you can observe our capacity and network expansion in more detail. During the quarter GOL operated an average of 51 aircraft, an increase of 41.7% over the Third Quarter of 2005 and 8.5% over the Second Quarter of 2006. When compared to the same quarter of the previous year, our capacity expanded 46.1% in terms of ASK volume to 5.2 billion. And RPKs increased 56.3% to 4.1 billion. When compared to 2006, the same quarter, ASKs increased 12.3% and RPKs were 16.6% higher. Such capacity expansion permitted GOL to reach 530 flights per day at the end of September 2006.

Moving on to slide number 6, our net revenues in the Third Quarter of 2006 grew by 55.5% to R$1.1 billion which compares to the same period in the previous year. Our capacity in conjunction with higher productivity, plays an important role in 3Q '06 revenue growth. It supports the highlights of our low fares, new modern aircraft and intelligent revenue management allowed our capacity expansion to further stimulate demand in our markets. GOL increased its productivity as a result of higher (inaudible) at 14.3 (block) hours per day during the quarter. And higher average (inaudible) which increased 4.3% year-over-year.

The ability to provide low fares has been a key factor to the GOL revenue growth. As the lowest cost provider of passenger air transportation in South America, GOL (inaudible) its demand with low fares and has increased the number of passengers traveling by air. Boeing estimates that traffic growth in South America will be at 7.4% annually over the next five years which is the second highest passenger growth rate in any region in the world after China.

11.7% increase in average fares during the quarter, combined with the 12.3% increase in average (inaudible) during the quarter resulted in a yield decline of 2.9% versus the Third Quarter of 2005 to 24.6% -- R$0.246. Higher load factors offset by lower yields resulted in revenues per available seat kilometer or RASK of R$0.208 which was a 6.4% increase versus the Third Quarter of 2005. Compared with the Second Quarter of 2006, yield increased 10.2% and RASK increased 14.3%.

The comparison year-over-year of our operating results is on slide number 7. You will observe the yields increased 2.9% in the year-over-year comparison. We increased all RASK by 6.4% which combined with the 46.1% ASK expansion resulted in a 25% growth in

EBITDAR amounting to R$317.3 million. EBITDAR is an indicator of operating results before accounting for aircraft ownership expenses such as aircraft to rent.

GOL's CASK at R$0.163 increased R$0.191 of ASK due to higher fuel costs, increases in scheduled maintenance expenses, increases in landing fees and higher depreciation expenses largely offset by an increase in (inaudible), lower aircraft to rent and a 7.3% appreciation of the Brazilian real against the US dollar.

Jet fuel expenses for ASK increased 17.4% over the previous year's quarter giving a 13.5% increase in the jet fuel price per liter in the quarter-over-quarter, year-over-year comparison. GOL's non-fuel CASK increased approximately 10.3% to R$0.0944 within our cost guidance for the quarter. The increase in fixed costs in the Third Quarter of 2006 was due to planned capacity expansion to support the growth in operations in the last quarter of 2006 when we will put 11 additional aircraft and three new bases into operation. To prepare for First Quarter capacity growth, we hired more than 800 employees during the Third Quarter of 2006 which represented an 11% increase in headcount versus the Second Quarter of 2006. And maybe (inaudible) training, technology as well as (inaudible).

Cost increases in the quarter were also driven by increased international operations, landing fares, increases in (inaudible) had increases at the beginning of the year and the proportion of international landings increased. The main expenses increased related to the scheduled (payment) of (six) engines in the quarter. The total expense in maintenance should continue at these levels for the next few quarters.

The strength in the Brazilian real has helped reduce our other US dollar denominated expenses such as aircraft rental insurance reducing these expenses, as well as US dollar denominated disbursements such as (inaudible) for aircraft acquisition. Coming off the main impact on operating margins, higher than expected jet fuel prices increased during the quarter and these were not compensated by higher yields during the quarter.

On the next slide, slide number 8, we show you our net financial results. Financial income in the quarter increased (R$4.4) million to R$61.1 million which reduced the higher investment income on cash balances. Our financial expenses increased R$15.7 million to R$24.5 million due to a planned increase in long term debt. Our net financial results for the quarter was R$21 million.

The next slide, slide number 9, shows the comparison of the effects of net income compared to the Second Quarter of 2006. In the Third Quarter of 2006, net income was a record R$190 million representing a 17.5% in income margin and a 37.5% growth over the Third Quarter of 2005. Running down the main differences, as highlighted already net revenues increased R$386.3 million. Jet fuel costs increased by R$149 million due to 58.3 million more liters consumed in the quarter and 13.5% higher fuel prices may increase 17.4% per ASK. Commercial expenses increased by R$45.6 million overall related to higher sale drawings and increased by 7.1% per ASK due to increased (inaudible) expenses and higher marketing costs.

(inaudible) sales on GOL's website over 80% of total sales during the quarter. Labor expenses increased 45.7 million overall and 16.2% per ASK due to 6% costs (inaudible) affected the beginning of the year. And an increase of 72% in the number of full-time equivalent employees related to the planned capacity expansion already highlighted.

Other operating expenses increased by a total of 96.1 million, principally due to an increase in the main success of 258.8% per ASK due to the scheduled maintenance of six engines, use of spare parts inventories and repair of (inaudible) materials. A 41.2% per ASK increase in landing fees due to a 21% increase in landing tariffs and an increase in landings at international airports which have higher landing tariffs.

And a 33.3% increase in depreciation. These were offset principally by 25.3% reduction in aircraft rent per ASK, a 7.9% reduction in other operating expenses per ASK. As mentioned, net financial results decreased R$5.7 million in the quarter.

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

In the Third Quarter 2006 earnings were R$0.97 per share or $0.45 for ADS which represented a 37% growth in EPS and a 41% growth in earnings per ADS over the Third Quarter of 2005. The net dividend payment of R$0.609 representing approximately R$0.29 per (inaudible) and other factors or $0.135 per ER was approved at the September 15 and October 27 Board meetings as interest on shareholders' equity, the shareholders (inaudible) on September 20, 2006. And as complementary dividends to shareholders of (inaudible) on November 14, 2006. (The interest on) shareholders' equity will be paid on November 14, 2006 and the complementary dividend will be paid on December 26, 2006.

On slide number 10 we show our cash flow for the Third Quarter 2006. At the end of the Third Quarter 2006 our cash balance was R$1.6 billion. During the quarter cash balances increased R$351 million. Operating cash flow was a positive R$316 million mainly due to increased earnings from operation, an increase in accounts payable and an increase in air traffic liability offset by an increase in accounts receivable and an increase in inventories. GOL currently has $183 million on deposit with lessors for future aircraft (needs).

Investing activities used R$15.7 million cash net consisting primarily of acquisitions of (inaudible) equipment and offset by R$38 million of returns of advances for aircraft acquisition and related to sale leaseback for six aircraft during the quarter. GOL currently has R$238 million in pre-delivery deposit, $230 million in (inaudible) deposits with Boeing for future aircraft acquisition. Cash provided by financing activities during the quarter was R$71 million consisting primarily of a $189 million increase in long-term financing, partially offset by R$119.7 million in dividends paid.

On slide number 11 we show the relative performance of GOL in the US and Brazilian stock markets. In 2006 through October 20, our EDS has outperformed the American stock exchange airline index at 15% during the year. And outperformed the Tier 1 LCCs by 22%.

Our PN shares underperformed the (inaudible) index by 8.1% in the same period. Our average daily trading volume in 2006 has been $27 million on the NYSE and R$12 million on the Bovespa. GOL's (inaudible) airline stocks and one of the most liquid resilient stocks included in the IBRX 50 index on the Bovespa.

On slide number 12 we show the range (inaudible) growth and profit margins continue to be a benchmark for the global airline industry. Our fee multiple is at a significant discount to the other leading low cost airlines, despite our superior earnings growth rate and profit margins which are among the highest in the industry worldwide.

Moving on to slide number 13, we show our current fleet pattern for the next six years. The addition of 11 more Boeing 737 aircraft to our fleet in 2006 towards the end of the year will allow an approximate 50% expansion in seat capacity for the full year. As announced yesterday, we increased the number of firm orders of Boeing 737 800-NGs from 67 to 87 aircraft. The company also increased the size of its firm orders by 20 aircraft to 121 737-NGs. This contract increase will guarantee GOL's expansion.

The company also increased its fleet plan from 2006 to 2012 to meet increased traffic demand in Brazil and South America. By the end of 2006 we expect to have 65 fully operational 737 aircraft. By the end of 2012 we plan to have a fleet of 101 aircraft, primarily 737 800s representing a 12% compound add annual -- average growth rate in fleet over the next six years. The incorporation of new 737 800s into the fleet is projected to produce substantial cost savings. The new aircraft will be equipped with fuel economizing winglets which will reduce up to 3% in fuel consumption per year and enable better flight (inaudible) increased (inaudible) length with non-stop flights. The new 737 800s are secure and the 737 700s which are the majority of the fleet we have today, can carry up to 30% more passengers.

Moving to slide 14 we present our financial guidance. And one of the key elements of our disclosure process. In the Fourth Quarter of 2006 the scheduled addition of 11 new aircraft to our fleet will allow a 50% increase in available seat capacity over the same period 2005. For the Fourth Quarter of 2006 we expect the load factor in the range of 73, 75% with (inaudible) in the range of R$0.26, R$0.28. We expect a stable foreign exchange rate environment for the near (term) which should be supported by good economic fundamentals in the present economy. We expect that high oil prices, historically high oil prices will continue to impact our fuel costs. For the Fourth Quarter of 2006 we expect non-fuel CASK to be between the range of R$0.092 to R$0.097.

For the full year 2006, we expect earnings per share to be in the lower end of our disclosed (inaudible) range for the year of 3.9 to R$4.3 per share, representing annual earnings growth of approximately 50% and annual earnings (inaudible) of approximately 55% which would compare to 56% annual earnings per EDS growth which we experienced in 2005.

Full year non-fuel (capacity) is expected to be in the lower half of guidance with our operating margins one to two points below guidance primarily due to the impact of higher fuel costs during the year which are not compensated by higher deals.

Financial guidance for 2007 is based on what was planned capacity expansion and the expected high demand for passenger transportation services, driven by strong Brazilian economic fundamentals and GOL's financing (inaudible) low fares.

For 2007 we expect to add 15 aircraft to the fleet and expand capacity by approximately 45% as we expected passenger demand and to add new routes and new markets in Brazil and South America.

Our projections are for a full year 2007 EPS in the range of 5.2 to R$5.6 per share representing annual EPS growth of almost 40%. Full year non-fuel CASK is expected to be in R$0.09 range. Full year operating margins are expected in to be in the 23% range.

We plan to continue to popularize air travel in South America through expansion, technological innovation, improved operating efficiency, strict cost management and the lowest prices. (inaudible) leadership who are committed to offer the lowest fares, generating high (inaudible) taxes and the possibility so that we can invest in more seat capacity and further stimulate demand, which is what we call the GOL effect.

I now turn the call back over to our CEO.

Constantino De Oliveira {BIO 3888521 <GO>}

Thanks Richard. These (inaudible). In September GOL's (inaudible) -- is aircraft maintenance (inaudible) (inaudible) when they take off (inaudible).

The construction began in July last year, we (inaudible) investment of R$30 million. The first modern center where we will perform (inaudible) maintenance in our fleet offers high end technology and airplane (inaudible).

(They are now contributions) I estimate at $2 million for the company which will stop using 35 (inaudible). The (inaudible) will also permit further maintenance service for our airline in the future. The total area of the maintenance center is 17,300 square meters. (inaudible) will be a one of 1,800 square meters for three airplanes and another, one of 2,000 square meters for one airplane. There will (inaudible) and business (inaudible) occupy 1,500 square meters.

Approximately 150 new jobs were created with the inauguration of the center. The (inaudible) location were (inaudible) as (inaudible) International Airport, one of the best in most (inaudible) the country.

On the slide number 16 on the webcast presentation where we saw a brief summary of several of our social responsibility programs, during Third Quarter '06, both social and cultural activities investing R$1 million in the period.

I will finish with slide number 17 where we highlight our competitive strength which are essential to our successful business model and the (business) cycle. We count on our high (inaudible) work force including management to always deliver (choice) customer service with low fares and the lowest cost in the market to keep our strong brand and high profitability.

At the last, to conclude this brief presentation we would like to invite everyone to participate in all day without (inaudible) which will take place in November 21 (inaudible). And includes a visit to our new (inaudible) maintenance center in (inaudible) on November 20.

Thank you for your patience and I would like now to turn the floor over for Q&A during which we will be happy to respond to any questions you may have.

Questions And Answers

Operator

Thank you. The floor is now open for questions. (Operator Instructions) Our first question is coming from Jim Parker of Raymond James.

Q - Jim Parker {BIO 1506864 <GO>}

Junior and Rich good morning. Couple of questions here. One is in looking at the domestic market in Brazil in the Third Quarter it looks like capacity growth is about 1% and RPK growth was about 5. So that's a substantial slowdown from what we've seen previously. And then in '07, you're looking at 45% capacity growth. Question one, what do you think the industry capacity growth will be and my primary question in this regard is, you're suggesting that if you put the seats out there, that people will get on. Meaning how long can this go on, you mentioned Boeing setting 7% traffic growth for the next five years. But we're seeing capacity growth way ahead of that rate. So -- at some point we're going to reach saturation here. When do you -- what's the outlook for the next few years in your opinion with this capacity growth being 45%?

A - Constantino De Oliveira {BIO 3888521 <GO>}

As far as your question Jim, if I might, when (inaudible) saw the progress of offering (inaudible) ASK and RPK, you can see that. The RPK really doesn't increase as much as we'd like to see for instance because the offering also didn't increase enough to allow the industry to grow as we were expecting.

Regarding the growth for next year for (inaudible) we expect to see our market grow between 12 and 14%. We believe that we are able to stimulate demand with low fares even for the next year, reduce our costs, then reinforce this (inaudible). We're stimulating demand, offering more seats and offering also (inaudible) population (inaudible).

Talking about South America, this projection from Boeing that we are expected to see the demand go up with 7.12% in the next five years. They've also reinforced our plans because that shows South America is able grow more than any other continent in the world (inaudible) China. That means that our special (inaudible) will be South American destinations and to offer service between the major destinations, the major markets in South America.

A - Richard Lark {BIO 3484643 <GO>}

Yes what (inaudible) First Quarter we had a large contraction of capacity came out of the market from one of our competitors. We have a full year that our competitor has reduced capacity by almost 50% of what he previously was operating here. So that had a big effect on what seats available -- that were available for consumption. And then also, (inaudible) we have probably let go of the size of the consumer's, (inaudible) in Brazil versus when we started back in 2001. I think we had about 5.5 million (inaudible) air travel in Brazil, today it may be worth nine. And our initial business (inaudible) built on that market being able to grow to 20 million in terms of a (inaudible) market. So we're still not even half-way there in terms of the capacity we would need to be able to serve up a market of 20 million individuals (inaudible).

Q - Jim Parker {BIO 1506864 <GO>}

Okay, my second question has to do with the profitability of international traffic in South America. Outside Brazil you're obviously going there rather aggressively and I'm just wondering, there's certain items that perhaps impact costs on the down side by having a longer stage (length) but just in general, you're thinking regarding the future profitability of international markets relative to your domestic markets?

A - Richard Lark {BIO 3484643 <GO>}

One of the things we don't -- you know, we have quite an integrated network. In other words the network doesn't have -- it doesn't have geographical boundaries. So in the global network we've been expanding within Brazil and now across borders of other countries of South America, it's really just an extension of the network. And the flights that we do to the international markets allow us to take advantage of downtime of aircraft, increased aircraft utilization, anything that should bring the global brand and product into new markets. A lot of this is based on flows between these countries and Brazil, which is the economic engine of South America.

Now, having said that, meaning that we don't necessarily have a separate international business which has separate profitabilities (inaudible). The way we look at it is it has (inaudible) really revenue contribution positive to the fixed cost of our overall network. Yes, we do have start up costs that relates to establishing our presence in these countries. We're currently in the process of opening a new international base in Lima and in the other bases next year which end up (inaudible) a cost. This is also true that some of the cost of operating in these countries are more expensive than Brazil. There's landing fees which can be two or three times more expensive than into Brazil.

Having said that, jet fuel in non-Brazilian countries is cheaper. So there's positives and negatives of operating in these countries. But on a -- we don't have a single flight in our international route which is not profitable, meaning that it's not contributing, making a positive contribution margin to the overall profits of the company. It's important to keep in mind that what we're in the process of building out is really one singular unified network which maximizes the ability of passengers to connect throughout the region, South America, Brazil, etc.

Q - Jim Parker {BIO 1506864 <GO>}

Okay, thanks.

Operator

Thank you. Our next question is coming from Mike Linenberg of Merrill Lynch.

Q - Mike Linenberg {BIO 1504009 <GO>}

Yes. Gentlemen. Good morning. I guess just a couple of questions here. Where are we on the process with the possible reallocation of some Varig slots from some of the congested airports? I guess at (inaudible) in particular. Is there any update on that whole process?

A - Constantino De Oliveira {BIO 3888521 <GO>}

Mike, it's Junior. Good morning.

Mike Linenberg; Hi Junior.

Regarding the Varig slots this (inaudible) is in the legal process or in the legal discussion between (inaudible) the agent in Brazil and the (judge). The judge in the case are (inaudible). And then but out of these we are looking across this to avenue (inaudible) offer new slots in countries that was not used (inaudible) is that slots were available, for a long time. And (inaudible) and will take place in Brasilia next week on November 8 if I'm not wrong. And that doesn't mean that we are talking about the (Varig slots). But it's other ones that's available that I don't think there will be any problem with this process. And we hope to see this going forward without problem.

Q - Mike Linenberg {BIO 1504009 <GO>}

Junior, the slots that are subject to the proceeding next week, how many slots are there, or slot pairs? I mean, what's up for grabs? Maybe just the round number of flights that would be available?

A - Constantino De Oliveira {BIO 3888521 <GO>}

13 slots. That means 26 across the 13 landings and 13 take offs.

Q - Mike Linenberg {BIO 1504009 <GO>}

Perfect. And then my second question is, can you just give us an update on what you're seeing on the competition in -- you know, this would be competition beyond some of these smaller carriers that over the past couple of months have announced their intention to go out and expand their fleets? And I'm talking about Ocean Air, BRA, Webjet, even Varig. I know Varig, the management team has been quoted pretty extensively talking about taking their fleet from, call it a dozen airplanes, up to 40 or 50 airplanes. We haven't a sort of timeframe but it seems like the aspirations are there to get a lot more -- a lot larger. What are you seeing if anything?

A - Constantino De Oliveira {BIO 3888521 <GO>}

Okay. First we have to observe what would be the (inaudible) that these companies will bring to the market. Or if they offer the same kind of service as the major carriers are providing. Looking in this way we expected to see a very competitive year on (inaudible) if everybody concludes their plans, that it grows. And we trust that we have the right solution for these competitive markets. That means we are able to reinforce our business (tactic), reducing costs and passing that to our customers. We also -- we expected to add to our process very well. And we believe that we are able to capture and re-stimulate demand with our lower fares. And so what I can presume for you that we expected to see a very competitive environment next year and we are prepared for that.

Q - Mike Linenberg {BIO 1504009 <GO>}

Okay. Great. Thank you, very much.

Operator

Thank you. Our next question is coming from Stephen Trent of Citigroup.

Q - Stephen Trent {BIO 5581382 <GO>}

Yes. Good morning gentlemen. To some degree building on Mike Linenberg's previous question. Looking at your expansion in the region, which I happen to think continues to be very impressive, to what degree are you continuing to see very strong numbers in terms of first time flyers? Let's say both in the domestic market and as you expand in the international market offering comparatively lower fares? Are we continuing to see, let's say increases and (inaudible) per capita in the region which still seem incredibly low compared to the United States for example?

A - Richard Lark {BIO 3484643 <GO>}

Yes. There is also the (overall) (inaudible) on passengers as a level comes out (inaudible) in terms of our -- the corporates in Brazil. We've consistently seen about 10% of our passengers transported represent individuals that are the first time traveling on a plane. We also this year saw an increase in the non-business component of our passenger base. Which at (inaudible) was maybe -- in the first year was maybe 20% business, 60% non-business. Then in some 2002 until 2005 it was pretty much 70% business, 65, 70% business purpose travelers and the rest non-business. This year that has gone to about 60%, say 60% traveling for business purposes, 40% for non-business purposes, which also shows the growth in the non-business part of the market.

The increase in seat offer has inhibited the ability of the business traveler to crowd out the non-business traveler. So there was more seats available. And we've seen lower prices. We also see an increase in the frequency of travel across the customer base.

As far as non-Brazil, what we kind of see there is actually the majority, 60 to 70%, of the passengers on the flights from non-Brazilian countries being non-Brazilians. And also something similar, 60 to 70%, being non-business. And part of that is because, as I was responding to the previous question, the flights into our international markets are really kind of more the equivalent of night flights, or late at night or early morning flights where they are for us helping us maximize aircraft utilization. (inaudible) in those markets tends to be more attractive to the non-business traveler where they call it the leisure or more (inaudible) traveler. So our (inaudible) is reflected in the lowest yielding traffic that we see in our non-Brazilian routes. There is a little bit -- some (inaudible) that we see on our side of the business, our particular business. But the data that comes out of the whole industry, there's generally a lag of one or two years before the actual official data comes out and we see a -- I think we're going to see something similar to what we've been describing in the (global business).

Q - Stephen Trent {BIO 5581382 <GO>}

Terrific. And just one quick follow-up question, looking upstream at jet manufacturers. There's plenty of news out of course on Airbus with manufacturing hold ups on that side, Embraer which we cover. There's been issues with manufacturing hold ups for them. Boeing are you -- do you consider to be satisfied so far with timely delivery of new aircraft?

A - Constantino De Oliveira {BIO 3888521 <GO>}

Yes we are satisfied with -- actually Boeing is supporting our role as being a very (inaudible) partnership or relationship between us and them and something specifically about the 737 800-SFP as (inaudible) performance. This aircraft has been wonderful for us and we are expected to take advantage of these -- development of this aircraft in (connect) here once this (inaudible) more representative in our fleet.

And I think that talking about the whole market, there is a limit to the availability of good aircraft in the market and now, with the position that we have, the orders that we have with Boeing put us in a very good position to take advantage of these good airplanes at this moment.

Q - Stephen Trent {BIO 5581382 <GO>}

Terrific, thanks very much guys.

Operator

Thank you. Our next question is coming from Ray Neidl of Calyon Securities.

Q - Christine Min {BIO 5802066 <GO>}

Good morning, gentlemen. This is Christine Min standing in for Ray. This is a follow up to a previous question. Can you give us your viewpoint on some recent studies that have come out proposing that the Brazilian market will continue to face downward pressures on yield, especially as the high rate of capacity enters the market?

A - Richard Lark {BIO 3484643 <GO>}

I don't know what studies you're referring to but the -- in our particular case, we -- our capacity expansion plan which, if we're (inaudible) number of aircraft (inaudible), our capacity, our need to (inaudible) new frequencies depends on having new aircraft because generally our ASK growth is the (inaudible) aircraft growth and we already -- we have in our (inaudible) business plan we already know we're going to (inaudible) capacity into the new markets that may -- from a competitive perspective, I guess what you're referring to, I guess there has been a speculation about what other companies may or may not do vis-Ã -vis putting aircraft into the market. The process for -- for deploying aircraft, (inaudible) in Brazil and we have (inaudible) confession in Brazil in an environment which has monitored capacity by (inaudible) through the regulatory authority which tends to watch statistics related to financial equilibrium or (inaudible) of many (inaudible) sectors whereas the financial health of the overall sector.

We just spent several years in Brazil correcting an imbalance and in the past caused a lot of financial problems for a lot of companies in Brazil. I don't think everybody wants to get back to that situation quickly in the near term. So just (inaudible) as the monitoring capacity environment in our market in Brazil. If a company wants to bring in aircraft without the (inaudible) I guess they could do that but in our particular case, the aircraft that we bring in, well they arrive at 8 o'clock in the morning and by noon on the same day they're already transporting passengers on the approved routes that (inaudible).

So our business process, our business plan works out. Having said that, there is a large capacity growth, what we do here if the approval process would change, we will permit capacity to come to the market which potentially didn't have demand. I guess my answer to that question would be the equalizing factor would be yields from an industry perspective, not necessarily (lows).

As far as (inaudible) yield also is that, (inaudible) but we see very high level of price (elasticity) in the business segment which is the majority of the passengers traveling (inaudible). It is very high level of elasticity, very (inaudible) elasticity in the non-business segment. So the ability for the market to keep growing (inaudible) have a very small market in terms of penetration. The ability to (inaudible) can depend on more seats being available and lower fares otherwise the market is not going to grow. In our analysis; the customers are there, which required is more product available at reasonable prices at (inaudible) to stimulate that. And for that it is necessary more capacity in the market.

And because of our particular expectation, -- we are expecting necessarily to see -- if there's an increase in fares, or increase in yield then next year's environment might be a combination of us operating at high (inaudible) factors which we have made adjustments in our operating (inaudible). The (inaudible) depends on pricing, (inaudible) more or less similar to something we've seen in 2006.

Q - Christine Min {BIO 5802066 <GO>}

Okay, that was very helpful, thank you.

Operator

Thank you. Our next question is coming from David Strine of Bear Stearns.

Q - David Strine {BIO 1541055 <GO>}

Thanks. Good morning gentlemen. Question regarding capacity growth again. I'm just interested in knowing what internal metrics you're using when you're making decisions about accelerating your capacity growth number one. And number two, what sort of flexibility do you have built in to your '07 ASK growth rate, be it from deliveries or how you're going to deploy the aircraft?

A - Richard Lark {BIO 3484643 <GO>}

Yes, hi David, we -- in front of the -- we are -- our process basically or our profit speculation capacity constrained environment versus where we can -- we are now assisting deploy capacity profitably. And one of the advantages that we have in our business models is high degree of connectivity in the network, which is very (inaudible) a lot of other business models which might be why -- exactly why it's hard to understand. But 50% of our volumes are connecting with through traffic so when we actually add new routes, the increase is -- loads indirectly on the overall network because of this high level (inaudible) international.

We have a process where we look at -- not only look at the available cost, we also allocate the fixed cost to the new routes and as I was saying before, we don't have routes that are (inaudible) positive contribution margins but basically that's the (inaudible) that we use when we look at route expansion is that they have to be -- they have to generate -- they have pay fixed and variable costs, assuming you would (inaudible) network (inaudible), we are (inaudible) six plus (inaudible) network. So we don't have a situation where there will be a (inaudible) (inaudible) to the complex analysis which is based on our estimates of putting these demands on our network today which (inaudible) place per day which running -- (inaudible) 57 aircraft in six different countries. But (inaudible) works like that.

In terms of the ability to tolerate our fleet, well yes we do have that. We've been in a process of actually trying to keep some of our aircraft longer than we initially expected, such as the 300 you see that we figure would hang on a little bit longer. We did return one 300 recently which was basically our first aircraft (inaudible). We have the ability to -- the arrivals of the aircraft on our (inaudible) Boeing are basically timed with the maturity of current operative lease. In that extreme case scenario that we have approximately 13 aircraft set out operating leases expiry next year. About 15 aircraft coming in. So if we wanted to we could contractually grow net two aircrafts next year, if we wanted to, of course we had not planned. So when the leases expire we are going to be working with those aircraft. We're looking at other aircrafts to replace them in the route network. So, we've got a very high level of flexibility to track capacity of this (inaudible) and that's not just 2007, it's 2007 and beyond. Having said that, we don't see that we actually (inaudible) answer the question. We feel more, in our particular case, we are in a capacity constrained environment, (inaudible) where we see the (inaudible) properly deployed aircraft (inaudible) more frequently and new markets as well as international expansion as well.

Q - David Strine {BIO 1541055 <GO>}

So, with the respect to the breakdown of the 45% growth in '07, assuming you get all the new international route authorities that you're looking for, what would be the breakdown in terms of ASK growth, domestic versus international?

A - Richard Lark {BIO 3484643 <GO>}

Our majority is still, the majority is still domestic. I question on making that distinction because it's not going, when we looked at it. But roughly 80, 85% of that growth is domestic. Although there's the (inaudible) life of the aircraft is 90% working on the Brazilian side of the border and 10% of the other aircrafts are, don't make that distinction. Actually we don't do that either (inaudible) you've heard of (inaudible) domestic routes of somewhere around 80 to 85% of the total if you were to look at it that way. Not that we don't have the capacity, if you will, or the critical mass to grow more aggressively. Internationally, our operations is basically finding holes in the network or finding holes in the aircraft utilization (inaudible) international flights which are generally longer haul and lower yielding and so now is not the right time for us to be growing the high risk internationally, until we get more critical mass in terms of the demand actually flowing through the air force that we're operating.

I think what (inaudible), we established a base in Argentina and it was in the following year we had the third largest (inaudible) in Argentina and all started doing flights between Argentina and non-Brazilian destinations, which is also something that we're doing in the Chilean market. Something we're doing with Chile now, we're doing between Buenos Aires and Argentina because Buenos Aires based and this allows us to collectively redistribute demand in Buenos Aires. So that adds that international piece itself (inaudible) three to five years as much as 25% of all productive aircraft capacity would be in those international markets. So we've got 8% right now, maybe that starts to triple up just 10 or 12% by the end of next year in terms of the non-Brazilian portion of our ASKs. But (inaudible) looking at because also the data that (inaudible) market share of the international market as disclosed, that's just market growth (inaudible) which is a very (inaudible) high which today (inaudible) represents less than 50% of the ASKs that are working in the international (inaudible) from Brazil.

Q - David Strine {BIO 1541055 <GO>}

Thank you.

A - Richard Lark {BIO 3484643 <GO>}

Okay.

Operator

Thank you. Our next question is from Travis Anderson of Gilder Gagnon & Howe).

Q - Travis Anderson {BIO 16488149 <GO>}

Good morning. I realize that a lot of unfortunate things can be said in election campaigns but there were a few alarming things from an investor's point of view said in the last few weeks. I was wondering now that it's over whether you think there's going to be any real change in course given the size of Lula's victory that might have any effect on GOL?

A - Constantino De Oliveira {BIO 3888521 <GO>}

Good morning, Travis. We don't think that the result of the election will affect the industry. We believe that we will still have conditions to increase our business model, that means we will popularize travel in Brazil and South America. And we had the opportunity to talk with Mr. Lula two weeks ago and he understands this proposition and it is something that he would like to see (inaudible). The Brazilians want a different airline helping the country to integrate South America and that's what we are doing and also (inaudible) population where we really allow them to fly more than ever.

Q - Travis Anderson {BIO 16488149 <GO>}

Okay. Second question is given the large number of new 800s you were saying that you would slow down on the 300 phase-outs but isn't there a fairly significant cost advantage of the 800s versus the 300s? Won't it help your costs quite a bit if you could phase those out?

A - Richard Lark {BIO 3484643 <GO>}

(inaudible) we have these rates that make up for that difference, load operating, (inaudible) aircrafts (inaudible) the age of those aircrafts and how that affects maintenance costs. But it's a question of capacity, availability. We're obviously very disciplined on how much we're paying for (inaudible) aircraft. We've been able to increase our deliveries with buying, not in the short-term period, not in 2006, '07 and '08, we will increase really those margins in 2008 and beyond. So, we're again working in the (inaudible) market to charge our capacity. We have developed the 300 capabilities. We've also recently launched our own maintenance services which also allows us to control better our costs of maintenance for that. So, in our particular case, there's the choice, there's no -- it really doesn't have a negative impact on profitability.

The issue really relates more to other things like the size of those aircraft, not being able to fully effectively utilize slots in restricted airports. Starting -- at the end of this year we are going to start to phase in the new 737 800-SFPs which are these aircraft configured with 187 feet into the real San Paolo (inaudible) market which will allow us 30% capacity increase without requiring (inaudible) in those quite restrained markets. So, there really, because of the smallness of the aircraft, that really constrains us more in those categories. From an operating perspective (inaudible) we're able to control that.

Q - Travis Anderson {BIO 16488149 <GO>}

Okay. And, finally, we haven't heard anything about Mexico lately. Any developments?

A - Richard Lark {BIO 3484643 <GO>}

Mexico meaning the joint venture (inaudible)?

Q - Travis Anderson {BIO 16488149 <GO>}

Yes.

A - Richard Lark {BIO 3484643 <GO>}

Because we are planning on starting flights to Mexico with the connection in Lima from (inaudible) so that's (inaudible) that's just basically. And I guess you could say just in a holding pattern. We have our joint venture, that was negotiated and it's just been in the refrigerator, we decided this year for a variety of reasons, one, given the maximum amount of start-ups in the Mexican market to take a latency attitude to see if our business flags still have an innovative -- something new to add to what's already being offered there in the market. We'll have to wait and see on that. Also to see what the cost structure of those companies looks like to see if we would have a competitive advantage.

Also, from our perspective, (inaudible) this year for us was the highest growth we've seen in terms of capacity and we wanted to make sure that our management and team resources were as focused as possible on what opportunities that we had at our fingertips.

So a combination of various factors, we haven't moved forward, we don't have concession approved which actually would be the next step in that process. So we'll probably evaluate that, next steps on that at the beginning of 2007 (inaudible) some real data that comes out of (inaudible).

Q - Travis Anderson {BIO 16488149 <GO>}

Okay, thanks.

A - Richard Lark {BIO 3484643 <GO>}

I think we've got time for one more question please.

Operator

Thank you. Our next question is coming from Rodrigo Goes of UBS.

Q - Rodrigo Goes {BIO 6232382 <GO>}

Hi, guys. Most of my questions have been answered. Just a couple of questions. I was wondering what your assumption for WTI is for your 2007 guidance? That's number one.

Number two, I was wondering if you could comment on what these delays all over Brazilian airports mean? What the cause is and how that may affect your earnings going forward?

A - Constantino De Oliveira {BIO 3888521 <GO>}

I'll answer the second part of your question first. We have seen many delays in some flights in the last two days regarding bases with aircraft control. But the impact of that we are -- we see this naturally as a show that means we'll have a little bit more cost, that means we are flying more to do the same flights that we did before. But we are talking about a short period of time and not talking about all our flights. So I don't think that will be enough to upset our results substantially. And the reason for that, it's difficult for us to say as we are out of this (inaudible) concessionary for air transportation in Brazil. We are very open to discuss and trying to find solution. We are able to do that. But that problem is too regarding to the authorities and the government who's responsible for this sector of the industry.

A - Richard Lark {BIO 3484643 <GO>}

In terms of our (inaudible) we are more of less using in those numbers Brazilian jet fuel prices which are flat or slightly above what we experienced in 2006. Having said that we should probably see jet fuel prices which are lower. And we got a substantial jet fuel price reduction in the months of October to December in the order of 10 to 12%, came back up a little bit -- it will come back up a little bit in December, at the range that we're able to spend, (of the 170 range). But next year we should probably be in the wide range on (inaudible). We're thinking it's kind of in the 165 to 180 range.

Having said that, you have -- projections (inaudible) really all across the board. And we continue to work our hedging program, which is based on our (inaudible) group policies. The problem with hedging over the past two years has been you haven't had any interesting (evacuation) of a (inaudible) to be able to put on long-term hedges. And (inaudible) right now is the highest it's ever been, everybody is waiting for that (inaudible) which is kind of in the 6% range now that's kind of come back down. It's not just a question of the absolute level of fuel prices, much more what's going on the (inaudible).

Our policies are ready to work to our favor to the extent that the (inaudible) we have works to go out a little bit along the curve and work out almost 80% hedge which is more at about one third hedge already on Q1 and Q2 of '07. This matches the question of the price model, it matches the question of the (inaudible) instrument as well as the (inaudible) which we've used that then incorporate the way that we've done hedging. We continue to look at that. But we expect the actual prices, oil prices to come down and jet fuel prices probably to be a little bit better than we're currently using in our planning for 2007.

We also expect that the stuff like the (inaudible) which will allow us to also do some provisions for hedging, vis-Ã -vis our business objectives. But I'll leave it up to you guys to quote the -- the WCI estimates into your models. But the data that we use has huge ranges, anything from 45 to $70. And we try to take a conservative view based on our experience and how that matches then with what's going on with our -- (inaudible). Because our hedging is not just on -- clearly on the cost side it's also going with what we expect on the lag between our cost increase happening, be it fewer dollars. And the ability to pass that on to yields. Which more or less (sinks) to the end of the (inaudible) back in May of 2005, that pricing part under that lag has really linked that out. And we've seen deeper correlation on our dollar side, kind of in the yields we're making, different correlations with the exchange rate kind of in the 50% range. But correlations with oil and fuel prices that got for some quarters down to zero, because the competitive element has been so strong and the competitive element has been looking less (inaudible) and looking at the other factors.

So part of that oil should depend -- and that cost if you will as a cost which should not just be viewed in isolation. But how that cost will affect operating margins for 2007, also depends on that relationship that we have seen up until mid-2005, with the very high levels of (inaudible) in the (70%) range which we haven't seen in the last year -- last year and a half. But this year coming is worth pointing out our preparation has (inaudible) that pass through element. A lag is much, much longer than it's been historically and will continue and -- so we're not sounding on that in the guidance that we've given for 2007.

Q - Rodrigo Goes {BIO 6232382 <GO>}

Okay, thanks a lot guys.

Operator

Our next question is coming from Mike Linenberg of Merrill Lynch.

Q - Mike Linenberg {BIO 1504009 <GO>}

Yes. You know, Richard, just really a follow up on Travis' question about Mexico. And I know you refer to it as a holding pattern. But then you laid out a very articulate rationale about maybe why it seemed like more than a holding period. That if you were going to do something within the Mexican domestic market it seemed like that if one were to describe a probability to that it would seem to be very low. And I just wanted to follow up any thoughts that it sounds like Mexico could be on the back burner for a couple of years and that Brazil is where the action is and that's where you're going to put your resources in building up your business in Brazil.

A - Richard Lark {BIO 3484643 <GO>}

Yes (inaudible) perspective. Our intention was never to be running a (inaudible) company but we would have to be heavily involved in (inaudible). So that does weigh heavily on (inaudible). Also point out that our -- the (inaudible) was always based on our ability to offer something to the Mexican population that it didn't have. So, I mean, that's really the number one main (inaudible). There isn't an ability for us to offer something. This is really -- it's a general overall business strategy which the only application that we found outside of Brazil, we've looked at a lot of different markets, was in particular the Mexican market to apply the gross formula there. We do think that it has applicability but there's been so much -- as much as 15 companies depending on how you want to look at it, starting up there in Mexico. Everyone's kind of thrown their hat in the ring.

We've spent maybe $350,000 on it. We're going to focus our time and energy where we can get the most bang for the buck. The (inaudible) of all business models and markets would follow a similar -- any market, in terms of establishing a local or domestic LCC would follow a similar analysis and thought process. We have looked at a lot of markets but the only one we found was Mexico. And then (inaudible) the Mexican government was stimulating development of the sector, attracted a lot of investment to the process there.

And maybe at the end of the day we were fortunate that we hadn't started up sooner than we were. That also involved, in our particular case, it also -- given an election year in Mexico, it also involved how we wanted to approach the (concession of rule) process. And so we decided not to put pressure on that given everything else that's going on as well. Because we thought to go through the process of getting a concession to be able to operate the public transportation concession in Mexico. But the other hand really, the sense that, a very nice set of joint venture documents that are sitting behind (inaudible) desk right now waiting for the right time to move forward on that.

Q - Mike Linenberg {BIO 1504009 <GO>}

Good. As they say, sometimes the best investment decisions are the ones that are never made. So good to hear and keep it going. â€¦

Operator

Our next question is coming from Bob McAdoo of Prudential Equity.

Q - Bob Mcadoo {BIO 1881798 <GO>}

Hi just a quick one. You made a comment when you were talking to Travis a minute ago which made some comment about a Mexican flight beyond Lima. Is that a connection to another airline? Or what would that be?

A - Richard Lark {BIO 3484643 <GO>}

That would be -- we would have a base in Mexico City, a city airport. And our aircraft has a range limitation. To cancel the direct flights would actually (inaudible) actually. Under bilateral agreements we have the ability to transport passengers between Lima and Mexico City. So in our business plan, end of this year, beginning of next year, to open our Lima base with flights from Brazil to Lima. And then on top of that, next year add a Lima Mexico City flight with a Boeing 737 800 landing into Mexico City which is 100% GOL, not through another airline.

Q - Bob Mcadoo {BIO 1881798 <GO>}

That would be done some time in late '07?

A - Richard Lark {BIO 3484643 <GO>}

I guess the next GOL -- the funding for the Mexico flights would maybe be Second Quarter of next year, yes.

A - Constantino De Oliveira {BIO 3888521 <GO>}

Yes, second or Third Quarter next year.

A - Richard Lark {BIO 3484643 <GO>}

A lot of it will depend on some timing and it also depends on where we want to deploy aircraft vis-Ã -vis what's happening in the Brazilian (inaudible). But the Lima base in itself should be end of this year, beginning of next year, there's the start of GOL flights to Lima. And similar to what we're doing with Buenos Aires and Santiago we can do flights under the bilateral agreements from Brazil to Lima, from Santiago to Lima, from Lima to Mexico. So we like this because it allows us to get the highly integrated network in these non-Brazilian markets, have higher (capitalization). And to some extent they'll also be allowing us to increase our air traffic utilization beyond levels that we've seen up until now. Because the aircraft they're flying there will be flying in at times when they would not otherwise be flying on the Brazilian (inaudible).

Q - Bob Mcadoo {BIO 1881798 <GO>}

When British airlines use the word creating a base or whatever, different airlines use that term to mean something different. What all is involved when you guys say creating a base in Lima? Does that involve having pilots there or flight attendants and pilots or maintenance or what?

A - Richard Lark {BIO 3484643 <GO>}

For us it's literally having a ticket counter at the airport. Obviously we have -- in the South American countries that we operate in, we have a very small administrative component. They will have a manager and the people that are going to be working there on a regular basis is related to the flight. And then operating with a temporary staff, a third party or temporary staff as it relates to dealing with the passengers. And then on the commercial side, we have more staff which deals with the distribution side of the equation, namely travel agents in the local markets. But it's a very, very small staff. Basically a ticket counter with a small (inaudible). We don't have -- neither in Brazil we don't have any physical facilities outside of what we have at the ticket counters at the airports. It's (inaudible) that's (inaudible). But average number of employees per day is possibly --

A - Constantino De Oliveira {BIO 3888521 <GO>}

In Mexico it's something like 30 employees.

A - Richard Lark {BIO 3484643 <GO>}

30 employees for each one of these and then operating with a lot of third party services for the other activities.

A - Constantino De Oliveira {BIO 3888521 <GO>}

I'll add something Bob. We are expected to extend our operations to Mexico by Lima, adding demand in Lima. That means we are following the same business models we are growing (inaudible) and we will extend our operation with the same aircraft, the same commercial approach and with the same operational staff as we have in our destinations here in South America. That means we will follow our business model.

Q - Bob Mcadoo {BIO 1881798 <GO>}

But the pilots and flight attendants would be Brazilian and based somewhere back in Brazil? That's what I understand?

A - Constantino De Oliveira {BIO 3888521 <GO>}

That's right, yes.

Q - Bob Mcadoo {BIO 1881798 <GO>}

That's it. I just wanted to ask you because when Ryan talks about creating a base somewhere like in Peru, if they were to do a comparable kind of thing, the buzzword base would mean that they would actually have crew members, pilots and flight attendants actually staffed and living in that city. And I just wanted to be sure I understood what you meant by creating a base. So your definition is different from theirs.

A - Constantino De Oliveira {BIO 3888521 <GO>}

Yes in this case we are not opening a base, we are opening a new destination.

Q - Bob Mcadoo {BIO 1881798 <GO>}

That makes sense. That's fine, I'm just curious. I just want to be sure I understood what you're talking about. Thank you, very much.

A - Constantino De Oliveira {BIO 3888521 <GO>}

Okay great. Thank you.

Operator

Thank you. I would now like to turn the floor back over to Mr. Oliveira for any closing remarks.

A - Constantino De Oliveira {BIO 3888521 <GO>}

Thank you. Once again, thank you very much for your interest in GOL. We remain committed to our goal of making air travel cheaper, more convenient and an accessible experience for everyone, while creating value for our shareholders and employees. GOL is popularizing air travel in South America due to the expansion of our business, innovation and our quality service, operating efficiency, cost management and competitive low price. At GOL, our slogan is here everyone can fly.

If you have an additional question please feel free to contact our investor relations department. You can also visit the investor relations section in our website at www.voegol.com.br/ir. Thank you. And have a nice day.

Operator

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