Q3 2008 Earnings Call

Company Participants

- Anna Cecilia Bettencourt, Financial Director & IR Officer
- Constantino de Oliveira, President & CEO

Other Participants

- Alex Loanzon, Analyst
- Daniela Bretthauer, Analyst
- Elizabeth Howell, Analyst
- Gustavo Moreira, Analyst
- Keith Weisen, Analyst
- Paula Kovarsky, Analyst
- Robert McAdoo, Analyst
- Stephen Trent, Analyst
- Tatiana Feldman, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. At this time we would like to welcome everyone to Gol Linhas Aereasinteligentes Third Quarter 2008 results conference call. Joining us today are Mr. Constantino de Oliveira, Jr., President and CEO. And Mrs. Anna Cecilia Bettencourt, Financial Director and Investor Relations Officer. (Operator Instructions) Today's live webcast, including both audio and slideshow may be accessed through Gol's website at www.voegol.com.br/ir.

Before proceeding, let me mention that forward-looking statements will be made under the safe harbor of the Security Litigation Reform Act of 1996. Forward-looking statements are based on beliefs and the assumptions of Gol's management and on information currently available to the Company. They involve risks, 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 will turn the conference over to the president and CEO, Mr. Constantino de Oliveira, who will begin the presentation. Mr. de Oliveira, you may begin your conference.

Constantino de Oliveira {BIO 3888521 <GO>}

Thank you. Good morning. Welcome to Gol's Third Quarter 2008 results conference call. The Third Quarter of 2008 was a very important for Gol. Despite the record high domestic fuel prices and incurring significant costs related to the aircraft returns, we were able to achieve our goal of profitable consolidated operations during the Third Quarter with an operating margins of 3.4%. Due to seasonality, decreased promotional activities, managed [ph] capacity reductions and system long haul operations, growth increased approximately 39% over the Second Quarter, leading to 31% increase in RASK over the same period.

Our punctuality rates were among the highest in the industry, which was 88% during the quarter and 92% in September. Our Third Quarter '08 compression rate was 98%. During the quarter, we took important steps towards improving operating efficiency and the quality of customer service. On September 30, 2008 our two operating companies, GTA and VRG merged into one airline following ANAC's approval on September 25. The merger allowed GOL to launch a new integrated route network on October 19 that complements the Company's unified structure by eliminating Gol and Varig's overlapping routes and schedules. The new network will also improve flight occupancy levels by allowing the Company to increase offerings in markets where it has consolidated operations while also allowing for new direct connections between previously unlinked cities.

We are also investing in our passengers' onboard comfort by adding value to the air transportation service. The integrating operations and the increasing scales that allow us as to improve onboard service without incurring additional costs by adjusting onboard meals to coincide with different flight lengths. In order to better serve business passengers, we expanded the Smiles, the largest mileage program in Latin America, to all of the Company's flights. We also launched the new comfort class on Varig's medium-haul flights in South America. We believe the integrated network, combined with initiatives to add value to our services and improve passengers' flight experience will provide our customers with the best service in air transportation in South America, allowing us to further increase load factors without increasing costs. We remain committed to our strategy of profitable expansion, based on a low-cost structure, quality customer service and developing our flight network.

Slide number one shows the Third Quarter highlights. The domestic passenger demand, as measured by RPKs, grew 8.7% year over year, demonstrating solid underlying demand for travel supported by a strong Brazilian economy. Consolidated operating income reached R$61.2 million with operating margin of 3.4%. The CASK reached R$0.174 per ASK, a 22% increase when compared to the same period last year, mainly due to the high -- mainly due to higher fuel prices, significant costs related to aircraft returns, shorter stay length and planned capacity reductions.

During the quarter, breakeven load factor decreased 19.9percentage points over second Q '08, reaching 57.9%. Low factor averaged 58% and 68% under the MASK and international markets' worst activity during the quarter '08. Combined load factors were at 60%, a 1.2percentage point decrease over third Q '07 and a 4.6percentage point decrease over second Q '08. Consolidated average passenger yields increased 39% when compared to the Second Quarter of '08. Third quarter '08 consolidated passenger volumes reduced 14% compared to second Q '08, mainly due to the planned capacity reductions. But grew 9% year over year. Average fares were R$275 or $144.

Please move to slide number two. On September 25, ANAC, Brazil's National Civil Aviation Agency, approved our corporate risk to restructuring plan for GTA and VRG. And on September 30, they were merged into one airline. Beginning October 19, the GTA and VRG flight networks were consolidated. This new network will be presented in more details on the following slides. As part of this restructuring, we have begun integrating a number of other processes including operations, systems, inventory, sales force and checking counters. We estimate that synergies resulting from the corporate restructuring call generate up to R$180 million per year in cost savings and increasing revenue.

On slide number three, we show the recent evolution of our RASK and CASK. RASK has returned to the 2006 levels of over R$0.18, offsetting higher costs mainly related to the higher fuel prices and maintenance expenses for aircraft returns. The 31% sequential increase in RASK was mainly driven by the 39% increase in yields and the 33% increase in ancillary revenues, which represented 10% of total revenue in the quarter.

Slide number four and five highlights the benefit of the network integration which allowed us 25 all go flights [ph] within one network improving connectivity and stabilization within the consolidated network. With integration we can also eliminate overlapping service to increase the efficiency of our Congonhas slot and offer passengers a more convenient flight schedule. For example, we removed ten overlapping flights per day from the Rio-Sao Paulo shuttle and now offer flights every half hour.

Through change like these, we are now able to offer flights between previously unlinked cities such as Congonhas-Maringa and Congonhas-Caxiasdo Sul. We were also able to increase flight frequencies on high demand routes such as Congonhas-Vitoria, Congonhas-Brasilia and Confins-Curitiba. We currently operate almost 800 flights per day.

Moving to slide number six, where we show our disciplined capacity growth. Over the next quarter we will maintain flat domestic ASKs as ceasing various intercontinental operations, we will reduce our international service offering. Domestically, this represents a 1% sequential increase in ASKs in the Fourth Quarter of 2008. In the Fourth Quarter, we do not expect any change to our consolidated fleet size.

I will now turn the call over to our finance director and investor relations officer, Anna Cecelia Bettencourt, who will discuss financial and operating performances for the quarter in more detail. Please, Anna.

Anna Cecilia Bettencourt

Thanks, Junior. Good morning, everyone. Please move to slide number seven in the presentation, which shows our capacity and network expansion in more detail. During the quarter the consolidated company operated an average of 103 aircraft which represents a 14% increase over the Third Quarter 2007 and a 5% reduction year over year -- reduction over Second Quarter 2008. The Company added 19 daily flight frequencies in the Third Quarter and now serves 59 destinations, more than any other Brazilian airline group.

When compared to the same quarter last year, our capacity expanded 11% in terms of ASKs volume to approximately R$10 billion, while RPKs increased 9% to R$5.9 billion. This capacity expansion permitted us to reach over 730 flights per day at the end of September 2008. With the integrated network we currently operate 794 daily flights. When compared to Second Quarter 2008, ASKs decreased 7.1% while RPKs decreased 13.8%.

Moving to slide number eight, we see that our consolidated net revenue in Third Quarter 2008 increased 37% to approximately R$1.8 billion. Although there was a planned reduction in aircraft utilization compared to the same period last year, we achieved aircraft utilization of 2.8 block hours per day during the quarter. RASK increased to 23.7%, mainly due to the 24.7% increase in yield. Ancillary revenues also contributed to results, growing 55% to reach R$178 million, 10% of the total net revenues for the quarter. Breakeven load factor decreased 1.9percentage points year over year.

Slide number nine shows our year-over-year comparison of operating results. Total CASK at 17.4% of the yield including fuel costs, increased 3.19 cents R$ [ph] for ASKs or 22% year over year due to higher fuel expenses, planned capacity reduction, lower stay length and increase in salary, rates and benefits, sales and marketing, lending fees and depreciation. Jet fuel expenses per ASK increased 36% over the same quarter last year due to a 42% increase in average fuel price per liter. Our consolidated non-fuel CASK increased 14% to 9.9 cents R$ [ph]. EBITDAR, an indicator of operating results before accounting for aircraft ownership expenses such as aircraft rent reached R$260 million.

The next slide, slide number ten, shows our net financial results. Due to the negative exchange variation, net financial results for the quarter were negative R$399.8 million due to negative exchange variation of R$261.8 million. Financial income in the quarter decreased R$57.7 million, due to a lower balance of cash and cash equivalents compared to Third Quarter 2007. We have invested approximately R$700 million of our cash, earning on average 13% in real. Total financial expenses increased R$63.2 million due to an increase in long-term debt. We have approximately R$2.1 billion of long-term financing with an average maturity of 7.2 years as an average rate of 6.2% per annum.

Slide number 11 highlights the effects on net income compared to Third Quarter 2007. As part of the process to transition the Company's financial statement from U.S. GAAP to IFRS, International Financial Reporting Standards, beginning with Third Quarter 2008 results, the Company will initially report its consolidated earnings in U.S. GAAP with the financial statement reported accounting to IFRS will be released by December 15, 2008. IFRS is the most widely assessed accounting standard internationally.

Running through the main difference in the Third Quarter 2008 U.S. GAAP results, net revenues increased R$485 million. Jet fuel costs increased 42% per liter to R$253 million or 36% per ASK, due to a 57% increase in WQI [ph] and 61% increase in the Gol's cost jet fuel. These costs were partially offset by a 13% appreciation of the present real quarter over quarter. Commercial rate expenses increased by 95% overall and 77% per ASKs due to higher sales incentive and lower aircraft utilization. Ticket sales on the website accounted for 67% of the total sales during the quarter.

Labor expenses increased 46% overall and 11% per ASKs due to a 5% cost of living increase on salaries and an increase of 11% to the number of full-time equivalent employees. Other operating expenses increased by R$60 million, principally due to a cost increase related to city intercontinental operations, passengers accommodation expenses, cancelled flights, crew lodging expenses and depreciation partially offset by appreciation of the Brazilian real.

In Third Quarter 2008, reported consolidated loss were 1.47 cents R$ [ph] per share or $0.88 per AGS. And reported net loss was R$294.3 million. These were the main factors impacting net income for Third Quarter 2008. A more comprehensive breakdown and explanation of our expenses can be found in our earnings release available on our website at www.voegol.com.br/ir. On slide number 12, we show our cash flow for Third Quarter 2008. Cash balance at the end of the quarter was R$724 million. Net cash used by operating activities were R$206.2 million, mainly due to a net loss of R$294.3 million, partially offset by an increase of R$92.8 million in accounts payable and other accrued liabilities.

Gol has approximately R$622 million deposit with leasing companies, primarily for future aircraft and engine maintenance. Gol has R$379 million of accounts receivable with no hold backs. Net cash used in investing activities was R$17.4 million, mainly due an increase of R$60.6 million in deposits for aircraft leasing contracts and R$18.2 million in acquisition of property plans, offset by R$61.4 million in return of pre-delivery deposits. Gol has approximately 668 depository points [ph] as advances for future aircraft acquisitions. Net cash provided by financing activity during the quarter was R$209.7 million, mainly due to R$131.6 million in exchange variations of long-term debt and R$51 million in short-term borrowings. During 2008, the Company used its own cash to repurchase 10% of its outstanding senior and perpetual notes in the amount of R$68.9 million.

Slide number 13 shows our investment and financing plans through 2010. Our investment plan for the next three years anticipates R$1.3 billion in aircraft acquisitions, R$910 million in pre-delivery payments for aircraft acquisition and R$530 million for investment in our maintenance, sales, IT and spare parts inventory. Of this total, we rely on approximately -- rely on financing to approximately R$2.1 billion in long-term financing for aircraft acquisitions guaranteed by Exon [ph] bank, financing for pre-delivery payments and BDMG financing for our maintenance center expansions in Confin [ph] as well as other sources of financing.

Slide number 14 details our exposure to exchange rate fluctuations. On September 30, 2008, we had a net liability exposure to foreign currency, which is the difference between liabilities and assets denominated in foreign currencies, up $700. This amount is subject to exchange variation and can have a positive or negative non-cash impact on our results. Effective risk management is essential to protect Gol from exchange variation, changes in oil price and interest rate fluctuations and their impact on our revenues expenses and cash flow.

In line with this objective in 2003, the Board of Directors published a risk management policy and a risk policy committee. The committee periodically reveals the measures taken to protect the companies from exchange variation and changes in fuel price and interest rate, outside the effectiveness of hedging measures taken during the previous quarter and approved recommendations for future changes and also conducts review of our cash management activity.

On September 30, 2008, we have contracted exchange rates and liberties to protect 46%, 25% and 12% of our U.S. dollar cash obligation for Fourth Quarter 2008, First Quarter 2009 and Second Quarter 2009 respectively. And had -- fuel had 3% of our Fourth Quarter 2008 consumption. Our risk management policy exclusively forbids directional bank and its local transactions with derivatives and requests the diversification of transaction and counter parties. The company exclusively uses unleveraged instruments and transaction with notional higher than our exposure are not permitted.

Please move to slide number 15. We have fluctuated results to finance our fleet plan, to continue our fleet renew and modernization strategy in accordance with our disciplined growth plan we end the final phase of replacing all 737-300s and 767-300 aircraft with 737-700 and 737-800s for operation on short and medium haul loads. In addition to reducing the fleet average age, these aircraft have lower operational costs and are more fuel efficient. The 737-300 NGs provides us with greater flexibility at airports with operating restrictions and the ability to offer more direct flights to medium-sized cities with lower traffic volume.

By the end of 2008, we expect that the fleet will be comprised mostly of Boeing 737 NGs, reducing the average age of our fleet to 5.6 years. At the end of 2012, 65% of the fleet will be comprised of 737-800 SFP aircrafts, reducing the average age to 5.5 years. We expect a total fleet of 104 aircraft by the end of the 2008, 108 aircraft by the end of 2009, 115 aircraft by 2010, 121 by 2011 and 127 by 2012, representing a 7% compound average growth rate in fleets between 2008 and 2012.

At the end of Third Quarter 2008, we had 95% remaining firm orders for Boeing 737-800 NGs to be delivered between 2009 and 2014, an additional 40 options for a total ward of 167 737-800 NGs. Please note that 32 had already been deleted by the end of Third Quarter 2008. This is one of the largest contracts in the world for Boeing 737-800 aircraft and guaranteed goals, expansion and position as one of the largest LTCs [ph] in the world. Our Boeing ward provides us the flexibility to convert 800 positions into 700 positions, allowing us to quickly adapt to market conditions.

On slide number 16, we detail our 2008 guidance for investors and analysts, changes versus our previous guidance related to exchange rate, fuel costs and tax rate. In 2008, we expect to transport 28 million passengers with our system-wide ASK of 41 billion and RPKs of 26 billion. We expect to end the year with a fleet of 104 aircraft. Cargo ancillary revenues are projected to grow to R$550 million, which is an increase of 10% versus our previous guidance and we'll continue to increase revenues driven from miles and very far to proven [ph] as well as other ancillary revenue-generating initiatives.

We project our average fuel cost per liter at R$2.05 for 2008, an 11% increase as compared to previous guidance. CASK ex-fuel is forecast at 9.4 cents R$ [ph], mainly due to expansion related matter for returning aircraft and lower aircraft utilization. We vested approximately R$950 million in 2008. For the Fourth Quarter 2008, reflecting network integration, we expect consolidated load factors of approximately 63% [ph] with consolidated passenger yield at approximately R$0.27. We expect consolidated non-fuel CASK to be in the range of 9.7 cents R$ [ph] or flat versus Third Quarter 2008. As we still expect to incur costs related to aircraft returns, we expect that incorporation of large, more fuel efficient aircraft in our hedging -- more fuel-efficient aircraft will partially offset eventually increasing fuel prices.

We'll now turn the call back over to our CEO to conclude our presentation. Please, Junior, go ahead.

Constantino de Oliveira {BIO 3888521 <GO>}

Thanks, Anna. I will finish with slide number, where I would like to reiterate our fundamentals as the largest low-cost airline in Latin America. We rely on the same principles we had in 2001 when we launched the company. We defined the way Brazilians travel and we established new standards in the Brazilian aviation industry. Today, however, we are larger and more solid, ready to compete and face the challenges of the industry especially [ph]. The fundamentals of our low-cost operations are sustained by the following pillars of our business strategy -- high aircraft utilization, the intelligent use of technology, a modern and standardized fleet and a focus on internet sales and a paperless ticketing system.

With the recent corporate restructuring we now operate five strong brands under one airline. Besides Gol and Varig, we have Gollog for cargo transportation, Smiles for mileage program and Boifasu [ph] for demand stimulation with discounted ticket sales. This is our main competitive strengths, which are essential to our successful business model. Our virtual cycle allows us to benefit from synergies, operate with the lowest cost possible and -- which immediately drives profitability.

We rely on our high productive work force and experience management team to quickly adapt to changing market conditions, deliver safe and high quality customer service, offer the lowest fares in the market and maintain the lowest cost in the industry to ensure strong brands and high profitability. Thank you for your attention. Let me now conclude this brief presentation. I would like to turn the floor for Q&A during which we will be happy to respond to any question you may have.

Questions And Answers

Operator

(Operator Instructions) Our first question will come from Duane Pfennigwerth from Raymond James. Please go ahead.

Q - Elizabeth Howell {BIO 18494868 <GO>}

Hi. This is actually Elizabeth Howell [ph] calling in for Jim and Duane. I was wondering if you could tell us for Q '08 guidance for points to a substantial RASK increase. Can you tell how loads are tracking in November versus October's 57%?

A - Anna Cecilia Bettencourt

Well hello, Elizabeth. Loads -- I mean, have only two weeks in loads for November and the loads are in the range for this two-week around 60% in the two weeks.

Q - Elizabeth Howell {BIO 18494868 <GO>}

Okay. Great. And assuming your R$0.27 yield, what is it quarter to date? Are you -- and are you expecting it to moderate or get better from here?

A - Anna Cecilia Bettencourt

In terms of yields, well, we are more or less in this also -- two week more or less in the same level that yields were in the second -- Third Quarter 2008.

Q - Elizabeth Howell {BIO 18494868 <GO>}

Okay. And this is the First Quarter, I think, where you're not providing a segment detail. Could you quantify the losses attributed to VRG and the portion attributed to VRG long haul operations?

A - Anna Cecilia Bettencourt

Well Elizabeth, we see that the long haul operations in -- the last one was varied which the service was seized end of August. So in the end of this quarter, end of September, we merged the VRG and the Gol into a single airline and since then we will be reporting as a single airline. So consolidated numbers. And now we have only operations for one airline.

Q - Elizabeth Howell {BIO 18494868 <GO>}

Okay. Then just finally, the net charge for currency hedge losses was R$48 million. But how large was the loss from unwinding fuel hedges versus the out-of-period gain on FX?

A - Anna Cecilia Bettencourt

Well the fuel hedge, I mean, we -- remember that we us the 5133. So we had some gains in the quarter related to our U.S. dollar hedges. Okay? But this gain could not 100% offset the losses that we had in that fuel. I can tell you that the net -- I mean, the gains related to fuel was not -- in the quarter was lower than R$60 million.

Q - Elizabeth Howell {BIO 18494868 <GO>}

Okay. Great. Thank you.

A - Anna Cecilia Bettencourt

You're welcome.

Operator

Thank you. Our next question will come from Mike Linenberg from Merrill Lynch. Please go ahead.

Q - Alex Loanzon {BIO 15160214 <GO>}

Oh, hey, everyone. This is actually Alex Loanzon on behalf of Mike. I wanted to find out if you could please comment on your competitive environment and kind of what you're seeing in various markets.

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

Well talking about the competitive environment today -- and so with the integrated network, we reinforce our business here in Congonhas Airport, one of the most important airports in Brazil. Or even the most important in terms of revenues. And with that we have been able to achieve offering of 41%, 42% of the market and our market share has been around 40%. Considering that and considering that other airlines, our newcomers are expected to come in December, as we are talking about Azul. And also we'll have Webjet. It's a smaller airline, which have plans for growth during this year and next one. We have been looking them, following their movements closely. And that's the environment where we are living today and also we still have our major competitive stand.

Q - Alex Loanzon {BIO 15160214 <GO>}

Okay. Thanks very much.

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

You're welcome.

Operator

Thank you. Our next question will come from Nicolina sic [ph] Sebrell from Morgan Stanley. Please go ahead.

Q - Tatiana Feldman {BIO 16528278 <GO>}

Actually, that should be Nicolai Sebrell and this is Tatiana Feldman [ph] in his stead. A couple questions, guys. If you could just tell us a little bit about the weight adjustments we should expect into the Fourth Quarter. I believe you guys generally put through salary increases in December. I wanted to know what that would look like. As well, if you could just give me some guidance into at what levels of effects the non-cash losses were contracted into the quarter. Thanks.

A - Anna Cecilia Bettencourt

Well our guidance for cost ex-fuel is presented in our guidance and for 2008 we expect to be 9.47 R$ % [ph]. We think we would also -- the salary increase expected in December this year. And the -- sorry, Tatiana. Could you repeat also your second question.

Q - Tatiana Feldman {BIO 16528278 <GO>}

Yes, I just wanted to understand a little bit of, I guess, slide 14 in the presentation. I just wanted to understand at what level the non-cash effects loss that was contracted into the quarter, at what levels of effects was that done for the BRL?

A - Anna Cecilia Bettencourt

Well this -- I mean, this is -- the net exposure that we have is $700 million, okay? So for -- and for this exposure, it depends, I mean, it's moved from -- at the end of the quarter, I mean, beginning of the quarter to the end of the quarter depends on the exchange variation end of each period. So that's why it's a non-cash -- has a non-cash impact -- that most of our liability has an average -- weighted average of 7.2 years from -- which means that we won't be paying outstanding debts during this period. If we were paying, we will be paying more of our debt.

Q - Tatiana Feldman {BIO 16528278 <GO>}

No, no. I understand that. But the non-cash effects loss, that was at the end of the period BRL rate or real rate for the end of the period, September 30 or --

A - Anna Cecilia Bettencourt

Yes.

Q - Tatiana Feldman {BIO 16528278 <GO>}

Okay. And the other clarification into that slide, the hedges, the effects hedges, what's the level there going into the Fourth Quarter -- the BRL level, the real rate?

A - Anna Cecilia Bettencourt

It's -- we have, I mean, our hedges are -- in the currency hedges of -- for the Fourth Quarter 2008, it's an average of R$1.95. Then it's a bit higher than that if you move to First Quarter and the Second Quarter 2009.

Q - Tatiana Feldman {BIO 16528278 <GO>}

Thank you. So much.

A - Anna Cecilia Bettencourt

You're welcome.

Operator

Our next question will come from Stephen Trent from Citigroup. Please go ahead.

Q - Stephen Trent {BIO 5581382 <GO>}

Good morning, everybody. I actually was not able to catch the whole call and I had some trouble logging onto your presentation. So I apologize if these are repeated. I was just curious, looking forward at your fleet plan, can you make any comment on how your financing for aircraft may have changed, let's say, in the last several months considering what's been going on with the credit markets?

A - Anna Cecilia Bettencourt

Hi, Steve. I mean, for the deliveries for 2008, 2009 and 2010, okay? These deliveries are pretty much financed. We use a mixed blend from Exon bank, using an Exon bank guarantee and we have already committed finance for the ones that we'll have, we use Exon bank guarantee. And also we have -- sale and leaseback transactions which also we have contract already signed and in place. So we are have financing for the deliveries for the next -- this year and the next two years' deliveries from Boeing.

Q - Stephen Trent {BIO 5581382 <GO>}

May I ask if your sale and leaseback program, if that indeed also runs through next year or if any color on what might be the tenor on that, the length on that?

A - Anna Cecilia Bettencourt

Well sale is back. We use a blend, in terms of ten or it ranges from nine to 12 years, more or less.

Q - Stephen Trent {BIO 5581382 <GO>}

Okay. Very clear. Thanks, Anna Cecelia.

A - Anna Cecilia Bettencourt

You're welcome, Steve.

Operator

Thank you. Our next question will come from Paula Kovarsky from Itau Securities.

Q - Paula Kovarsky {BIO 15363001 <GO>}

Hi, everyone. I have actually two questions. The first question has to do with load factors because in October you actually blamed the low load factor on problems with the integration of Boeing and your G systems. So I would like to know how is this process and if there's any remaining problems that could eventually affect the Fourth Quarter. So this is the first question.

And second question has to do with ancillary revenues. So how recurring are them because this -- I mean, comparing to my numbers, what the biggest surprise. So I would like to understand how recurring they are and, in essence, understand why is it that the guidance was significantly lower. I mean, plus or minus 1% EBIT margin versus the 3.2%. I mean, this is, of course, a good surprise. But I would like to understand the main differences from the point you've guided and what happened, actually.

A - Anna Cecilia Bettencourt

Well just beginning from the last question, I mean, what we guided was also our guidance. So guidance of running the numbers and doing all the adjustments. And we came up with 3.4% operating margin. So we guided, we assumed a conservative approach and then when we run the numbers, finalized all the process, the margin was 3.4%.

Q - Paula Kovarsky {BIO 15363001 <GO>}

But what was the main source of surprise?

A - Anna Cecilia Bettencourt

Positive surprise is always welcome, isn't it?

Q - Paula Kovarsky {BIO 15363001 <GO>}

No, no. My question is from the point you've guided to the actual numbers, what was the main surprise from your perspective?

A - Anna Cecilia Bettencourt

No main surprises. It's a matter of just finalizing all the accounting and on getting to the final number.

Q - Paula Kovarsky {BIO 15363001 <GO>}

Okay.

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

And regarding the first question, sorry, Anna, you can also develop something from ancillary revenues.

A - Anna Cecilia Bettencourt

Ancillary revenues in the quarter was R$170 million -- increase of R$178 million. And it was mainly related to Smiles, our Smiles program, okay? This quarter represented about 10% of our net revenues. But you can a model, you can use an average between -- for the Fourth Quarter, you can use an average of 8% to 9%.

Q - Paula Kovarsky {BIO 15363001 <GO>}

Okay.

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

Related the integration of both company, the sales systems and also the fleet network, we suffered a little bit in October, as I said, the reflect of this integration. During November, we are seeing things are getting normal in terms of system integrations. But we will see 100% of these synergies gains just on the First Quarter '09 when we will have 100% of our flights under the same revenue management and under the same reservation systems, our sales systems. So saying that we are not changing, that is not -- will not affect our projections for the Fourth Quarter. We incorporate this integration. That means we are still running the integration and taking the benefits. But 100% of them will come just on the First Quarter '09.

Q - Paula Kovarsky {BIO 15363001 <GO>}

Okay. Thank you very much.

Operator

Our next question will come from Robert McAdoo from Avondale Partners. Please go ahead.

Q - Robert McAdoo {BIO 1881798 <GO>}

Thank you. Just a couple of questions. The yield is up over 20%, it seems. And I was wondering, is that -- how do you raise the fares that much without necessarily changing all this traffic? And I guess one of the questions is a couple of years ago when we were down there, you had a presentation which included a substantial amount of flying in the middle of the night, trying to introduce the lower class, lower economic class people to flying. Is that process still going on? Is that -- or have you eliminated some of that to get the yields up? I'm curious as to how you got yields up as much as you did.

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

Yes. If you compare our yields with 2006 yields, you're going to see that we are now working with the same level as we had two or three years ago. So considering that, we still have a very affordable fares for the domestic market. When you see just the yields and fare, you will have to also to understand that we stopped our long haul flight on August. And this kind of international flight push yields to a lower level than on the domestic market. So we have to consider that.

Regarding demand stimulation, we reduce our night flights, our red eye flights during the Third Quarter. We've disintegrated fleet network. But we are still offering fares as low as the bus fares on -- especially when we talk about two or three hour's flight. And these fares are available with some restrictions. That means minimal stay on the destiny. But are available on our website and we have been stimulating demand with these lower fares, even on our daily fights.

Q - Robert McAdoo {BIO 1881798 <GO>}

So the really inexpensive fares are now limited seats during the day as opposed to the dedicated flights in the evening. Is that what you're saying?

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

Exactly. Exactly.

Q - Robert McAdoo {BIO 1881798 <GO>}

Okay. A couple of other things. We read up here about Azul and lots of noise about Mr. Neleman [ph], obviously. Can you -- but then you talk about them starting in December. But we have yet to hear anybody talk about where they're flying and whether they're actually accepting reservations or whatever. Can you tell us what you're seeing? Are they -- have they announced any markets? Are there markets that are directly competitive with you people? What do you know about what's going on?

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

We are hearing the same notes as you are. We don't know exactly where they will fly. But in our projections we are assuming that they will established themselves with the same market -- the same -- the average of market efficiency. That means they will compete with us. But we don't know yet where and what kind of service offers they will provide to the market. So it's too early, too preliminary to talk -- to say something because we really don't know exactly where they would -- and which markets.

Q - Robert McAdoo {BIO 1881798 <GO>}

But they're actually saying that they're going to start operations in December. Is that -- because if they're starting in December, you would think they would be starting to take reservations by now. Is it really December that they're thinking about?

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

Yes. We are hearing that. They are -- of their flights in December.

Q - Robert McAdoo {BIO 1881798 <GO>}

Okay. Interesting. Interesting. What do you currently -- I guess -- and then can you tell a couple -- just a couple quick -- the quick ones. On fuel, as fuel has come down and the barrel of oil is much cheaper, what are you currently paying for fuel? What -- like now that fuel is in the $50s in terms of per barrel?

A - Anna Cecilia Bettencourt

Yes, using the projections that we gave to the market, we project -- I mean, WQI on average for the Fourth Quarter 2008 of R$75.5 million with an exchange variation of R$2.02. So we will get price per liter around R$2.15, R$2.18.

Q - Robert McAdoo {BIO 1881798 <GO>}

Is that like your most recent daily purchase or is that an average for the quarter?

A - Anna Cecilia Bettencourt

It is based on our projections for the Fourth Quarter 2008.

Q - Robert McAdoo {BIO 1881798 <GO>}

I was just curious, as it's come down some since that even, from R$75 million on down, what do you -- what are you having to pay now? Because sometimes it's hard for us to understand because of the taxes and the procedures you have, as it used to be described to us. Just curious as to what you're having to pay currently.

A - Anna Cecilia Bettencourt

Well it depends, I mean, on Petrobras, they use an average of past amounts, WQI and heating oil. So was are not yet benefiting from the current decline on the WQI that we have seen in the market.

Q - Robert McAdoo {BIO 1881798 <GO>}

Okay. Then one -- and then just finally one more. There was, in the detailed release, there was discussion that says that some of the 767s are still on the property even though you're not flying them that said they may be available for cargo or something if something came up. I'm just curious as to how many are still around, what kind of carrying costs do you have of still having them around. And what is the prospect, do you think? What's the market like in terms of the ability to go ahead and get them off the property?

A - Anna Cecilia Bettencourt

Well we ended September with seven. And we are currently negotiating them. Some we have already -- or we are about to reach agreement. Others we are still negotiating.

Q - Robert McAdoo {BIO 1881798 <GO>}

Is -- does -- in terms of your ongoing costs of continuing to have those until you can get them disposed of, how -- what is the amount of that? How is the magnitude of that cost?

A - Anna Cecilia Bettencourt

Well in terms of the projections that we have, we are projecting to maintain about five these other in the beginning, during next year 2009.

Q - Robert McAdoo {BIO 1881798 <GO>}

And what would be the carry -- the operating costs of just holding those airplanes idle. Just -- what is the load ...

A - Anna Cecilia Bettencourt

An average of the lead rate for this aircraft average -- $500,000 per month.

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

Per Aircraft.

A - Anna Cecilia Bettencourt

Per aircraft, sorry.

Q - Robert McAdoo {BIO 1881798 <GO>}

Sure. Sure. Okay. Thank you very much. You've been very helpful.

Operator

Our next question will come from Keith Weisen [ph] from Caylon Securities. Please go ahead.

Q - Keith Weisen

Hi. I wanted to ask a question on slide 13 where you laid out your financing sources, specifically about the line labeled other CapEx and then secondly the line labeled own resources. I wonder if you could just talk about what those are, more specifically.

A - Anna Cecilia Bettencourt

Well it's basically related to a portion of the aircraft that -- the equity portion of our aircraft that we purchased. So you can consider that off our CapEx, about 95% aircraft acquisition. And for the exiting bank, guarantee -- normally we receive about -- approximately 85% of the value of the exit [ph]. So this relates to the 15%.

Q - Keith Weisen

So that would be a cash contribution on your part?

A - Anna Cecilia Bettencourt

In terms of -- yes, a cash contribution. But the payments were already made when we make the down payment.

Q - Keith Weisen

I see. So that's already been funded is what you're saying.

A - Anna Cecilia Bettencourt

Yes.

Q - Keith Weisen

Okay. And own resources?

A - Anna Cecilia Bettencourt

Own resources, it's investments, I mean, for parts and equipment mainly and we are talking about own results from 2008 to 2009 -- '10, sorry.

Q - Keith Weisen

You're saying from cash on hand ...

A - Anna Cecilia Bettencourt

It's related to other investments such as mainly the airport and airport maintenance. And for investments we're expanding our service -- maintenance service in Maringa [ph]. Okay. So these are the investments that we have.

Q - Keith Weisen

And that would be funded through cash on hand.

A - Anna Cecilia Bettencourt

A portion, yes. And another portion, no. Yes.

Q - Keith Weisen

Okay. And just a follow-up. Somebody asked about the October traffic. I was wondering if you could help us understand, in terms of the drop in load factor, how much of that's attributable to an overall drop in demand in the market? I mean, Tam reported a drop in load factor as well, domestically. But not quite as much as you guys reported. So I was wondering if you could speak to the current demand in the Brazilian market and if you have any commentary on November as well, on the demand front.

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

Okay. Regarding October, we have to understand that we reduce our capacity. We did a planned reduction. With that we lose some connections and the complementary revenues in some flights that comes from connections. We're saying that. And also we started a new fleet network in October 19 and we launched a new reservation system on August which affect our sales from the beginning of October -- for August and October, for example.

Saying that, we -- in November we are seeing that we have been nearly through the previous number that we provide guidance for Fourth Quarter, where we indicated a 63% load factor on the average. And our load factor is increasing. And our sales are going on the directions which allow us to -- not to confront. But to make this guidance, I would say, touchable.

Q - Keith Weisen

Okay. So some of the reduction was specific to October and you're saying that's changed in November going forward.

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

Yes. We have to see that our new fleet network just on November -- sorry, October 19 and we suffered a little bit on the load factors for the end of October and the beginning -- just the beginning of November. But things are becoming to the normal way and we confirm the 62% load fact on average for the Fourth Quarter.

Q - Keith Weisen

Okay. Just one more question. Your yields were up strongly. I was wondering how much that was due to fuel surcharges and now with oil at 50 some odd dollars a barrel, how much we can expect yield to potentially go down just based on fuel surcharges coming out of the ultimate fares you're charging?

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

Well we don't have fuel surcharge in our revenues here. So as we are flying domestically in South America, we are not -- we were not asking for fuel surcharge in our ticket. So we are not expected to see any different yields coming from fuel surcharge.

Q - Keith Weisen

So it's entirely from fare increases or mostly from fare increases?

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

We -- not just from fare increases. As we said as we started the long haul flights, which represent the lowest yields in our operations, automatically we saw better yields. And regarding in the Fourth Quarter we are talking about the yields that we are projecting considering the level of oil price that we have today.

Q - Keith Weisen

Okay. Thank you.

Operator

Our next question will come Ms. Daniela Bretthauer from Goldman Sachs. Please go ahead.

Q - Daniela Bretthauer {BIO 13380169 <GO>}

Hi. Good morning, everyone. A quick question to Anna. Whenever do you think your breakeven load factor would be in the Fourth Quarter given the drop in fuel? That's the first question.

A - Anna Cecilia Bettencourt

Well it's -- considering the fuel, in the Third Quarter, breakeven load factor were 57.9%. Clearly, it will benefit the breakeven load factor in the Fourth Quarter. We can say that depending on -- it can be around -- it can decline one percentage point, two percentage points, the cost that we presented in the Third Quarter.

Q - Daniela Bretthauer {BIO 13380169 <GO>}

Okay. Thank you. Then second part of the question is just going back to your hedging strategy, fuel hedging strategies. So you basically unwinded all your fuel hedges in the third -- at the end of the September and where are you right now? I mean, are you reviewing those hedges? Are you not hedged at all? Then hypothetically speaking, let's say if you were hedged, would you also have to market to market those positions?

A - Anna Cecilia Bettencourt

Well answering [ph] we have a committee that just published the guidance and the -- we have our hedging program. The committee approved the strategy and the volumes and the triggers for our hedging program. What I can tell you that, based on the committee, I feel we are building up again our hedges position for medium term, not short term. And regarding the market to market, what we do, we use the FAS 123 as accounting. Okay? So the accounting goals of period to period. So one is not the period that we account as the OCI [ph] during -- for future periods.

Q - Daniela Bretthauer {BIO 13380169 <GO>}

But do you book that at the cost of fuel or do you book at the financial results?

A - Anna Cecilia Bettencourt

We view that based on the effectiveness of the hedging program and the specific hedge that we have.

Q - Daniela Bretthauer {BIO 13380169 <GO>}

In what line? Sorry, Anna. I mean, just the market to market specifically. Does it go in financial results or does it go in the cost of ...

A - Anna Cecilia Bettencourt

If it's uneffective, it goes to financing results. If it's effective, it goes to our -- it goes to the operating line.

Q - Daniela Bretthauer {BIO 13380169 <GO>}

Okay. Thank you.

A - Anna Cecilia Bettencourt

You're welcome.

Operator

Our next question will come from Gustavo Moreira from UBS. Please go ahead.

Q - Gustavo Moreira {BIO 21579669 <GO>}

Hi. Good morning. Just going specifically in your Third Quarter result, I was wondering if you could tell us if there are any one-offs in your other operating expenses. I mean, can we expect it to remain in the same levels going forward?

A - Anna Cecilia Bettencourt

Well as we explained, there were associated costs related to shutting down our long haul operations that affected the quarter. Okay? We estimated as extraordinary costs, not only to -- and also costs related to returning this aircraft, which made that is extraordinary costs -- around R$30 million in the quarter -- Third Quarter 2006. In terms of guiding [ph] we expect to see our kaski [ph] in the -- during the year to decline and ex-fuel to be, for 2008, to be R$9.47 for the year. This is our guidance. This improves already. There's some -- still some extraordinary costs related to this that we recognize in the Third Quarter and Second Quarter 2008.

Q - Gustavo Moreira {BIO 21579669 <GO>}

Okay. Thank you.

A - Anna Cecilia Bettencourt

You're welcome.

Operator

Thank you. This does conclude today's question-and-answer session. I would like to turn the conference back over for any closing remarks.

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

Okay. Once again, thank you very much for your interest in Gol. We remain committed to making our travel a simple, more accessible option for everyone. So our initiatives -- initiative quality service -- sorry, novelty quality service, efficient operations and competitive low prices. If you have any additional questions, feel free to contact our investor relation department. You also can visit the investor relations section in our website at www.voegol.com.br/ir. Thank you very much and have a nice day.

A - Anna Cecilia Bettencourt

Thank you.

Operator

Thank you. This concludes Gol Linhas Aereasinteligentes Third Quarter 2008 results conference call. You may disconnect your lines at this time.