

**GOLLBZ 8 7/8 01/24/22**
**L LONG**
**GOL Linhas Aereas Inteligentes SA**

Credit, Industrial/Transportation

01/23/2017

**PRESENTED**
**CURRENT**

|            |               |           |                                                                                                                                                                                  |          |            |         |
|------------|---------------|-----------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|------------|---------|
| DATE       | 01/18/2017    |           | PRICE                                                                                                                                                                            | R\$12.55 | MARKET CAP | \$1.49B |
| PRICE      | MARKET CAP    | ENT VALUE | Image type unknown<br>Chart<br><a href="http://portal.dmlc.com/storage/ideas/Chart/a08A0000017nIRyIAM.jpg">http://portal.dmlc.com/storage/ideas/Chart/a08A0000017nIRyIAM.jpg</a> |          |            |         |
| R\$N/A     | N/A           | N/A       |                                                                                                                                                                                  |          |            |         |
| P/E RATIO  | BOOK VALUE    | DIV YIELD |                                                                                                                                                                                  |          |            |         |
| N/A        | R\$N/A        | %         |                                                                                                                                                                                  |          |            |         |
| SHARES O/S | AVE DAILY VOL | SHORT INT |                                                                                                                                                                                  |          |            |         |
| N/A        | N/A           | N/A       |                                                                                                                                                                                  |          |            |         |

Public companies mentioned herein: GOL Airlines (GOLL BZ), Smiles (SMLE3 BZ), LATAM (LFL) and Delta Airlines (DAL).

**Highlights**

A distressed Brazilian airline, the presenter sees GOL Airlines as having a fundamentally misunderstood and mispriced capital structure. The company is the largest airline in Brazil, and the only publicly traded airline operator in the country. GOL has approximately \$600 million in unsecured debt across 3 separate issues. While he believes all the bonds appear cheap at current levels, the presenter is recommending the 8.875% bond due in 2022, which effectively creates the business at about 5 times forward EBITDA. Currently trading in the high 60s largely due to ongoing macro weakness in Brazil, the presenter believes the bond will ultimately trade to par. A performing credit despite its distressed pricing, it has a one year return profile of 40-45 percent. The presenter expects various positive catalysts to play out over the next 6-12 months, with investors getting paid a 13% current yield while they wait.

- The presenter's view differs from the market in two key ways: available liquidity and industry fundamentals - including the potential for industry consolidation.
  - Liquidity: GOL appears to have just 18 months of liquidity on paper. The company is essentially at free cash flow breakeven before cap ex and debt amortization, and owes about a billion reais in debentures held by two banks, with about 400 million in reais coming due in 2018 and 2019. However, the presenter believes the company has a number of levers available to it.
    - ▶ The billion in reais is unsecured and held by two "friendly" Brazilian banks that are not inclined to be aggressive, according to the presenter.
    - ▶ Additionally, GOL has unpledged accounts receivable, and as much as \$200 million of untapped equity in GOL's unencumbered aircraft. Most importantly, however, the company enjoys certain benefits from its ongoing relationship to GOL's publicly listed frequent flyer program, Smiles (SMLE3 BZ) (GOL owns 54% of the company).
      - ▶ Typical of such programs, Smiles buys seats from GOL at a discount and then sells miles to various credit card companies whose customers eventually redeem for flights. GOL's financial interest in

- ▶ Smiles is equivalent to roughly USD \$1 billion, according to the presenter, which in essence represents a form of untapped liquidity.
  - ▶ An additional important point as it pertains to Smiles is that the program generates strong free cash flow and the company needs to put that capital to work. Smiles is in effect lending money to GOL on an unsecured basis by buying seats from GOL in advance at a discount. Smiles last year bought about 1 billion reals in seats in advance from GOL. The arrangement makes sense for both parties given their symbiotic relationship – Smiles gets an attractive effective yield by buying seats at a discount, and at the same time helps ensure that GOL - its sole vendor - remains viable.
  - ▶ Smiles has used up nearly all the seats it purchased in advance from GOL last year, and the presenter expects that Smiles could once again look to make purchases in advance.
  - ▶ The presenter noted that GOL's interest in Smiles provides for various hedging strategies for investors who are concerned about the potential for GOL debt to once again trade at distressed levels.
- Industry fundamentals: The market is dominated by GOL and LATAM (LFL). Both companies are reducing capacity faster than demand in the region is falling, in the high single digit range. Meanwhile, a single irrational player – Avianca Brazil – continues to add capacity at a similar rate. A highly distressed private company, Avianca increasingly has been defaulting on its leases, according to the presenter. He believes the company could eventually end up being acquired or liquidate altogether. In that context, potential consolidation could meaningfully impact industry fundamentals, with the potential for materially higher yields and less overall leverage for the surviving players.
- The presenter believes GOL is perhaps the most highly levered Brazilian company to the USD:BRL exchange rate. Reals are currently trading at 3.2 to 1 to the dollar, but the exchange rate previously had been as high as 4 to 1. The recent real strength has been a strong tailwind for GOL, as the company's debt and operating leases are denominated in dollars while 100% of its revenues are in reals.
  - Looking at the capital structure, GOL has an approximate \$3.3 billion enterprise value, with \$2.7 billion in total net debt and \$600 million in equity market cap. With GOL's unsecured debt totaling about \$600 million, the company is currently trading at roughly 6 times through the bonds.
    - The bonds create the business at roughly 5 times EBITDA on market basis. There are approximately 4 turns of leverage ahead of the unsecured debt, but most of that is in capitalized operating leases and unsecured bank debt (the presenter noted that most financing in Brazil is done on an unsecured basis).
    - GOL's equity is 60% held by the Constantino family, while just under 10% of the common stock is held by Delta Airlines (DAL). Delta also has a seat on GOL's board, and currently guarantees approximately \$300 million of the company's bank debt. The presenter described GOL as a key strategic partner for Delta, representing the carrier's primary point of access to the LatAm market – an important growth market for the global airline industry.
    - The partnership between the two airlines appears solid. The presenter noted that under current regulations, Delta is unable to acquire a Latin American airline outright, so its relationship with GOL has ongoing value to the American carrier.
    - Importantly, the presenter sees Delta as the ultimate backstop for GOL in a downside scenario given its extensive interests in seeing the Brazil carrier succeed.

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