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LAN.SN - Q2 2015 Latam Airlines Group SA Earnings Call

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PRESENTATION

Operator

Good day, everyone, and welcome to LATAM Airlines Group earnings release conference call. Just as a reminder, this conference is being recorded. LATAM Airlines Group earnings release for the period was distributed on Thursday, May 14. If you have not received it, you can find it in our website, www.latamairlinesgroup.net, in the investor relations section. At this time I would like to point out that statements regarding the Company's business outlook and anticipated financial and operating results constitute forward-looking comments. These expectations are highly dependent on the economy, the airline industry and international markets. Therefore, they are subject to change.

Now, it is my pleasure to turn the call over to Ms. Gisela Escobar, Senior Corporate Controller and IR Officer of LATAM Airlines Group. Ms. Escobar, please begin.

Gisela Escobar - LATAM Airlines Group SA - Senior Corporate Controller and Director of IR

Thank you very much and good day, everyone. Thanks for joining our call. We are here with Andres Osorio, who is the CFO of LATAM Airlines Group; and we're also joined by Roberto Alvo, who is in charge of the international passenger operations; Andres del Valle, who is in charge of corporate finance; and from Brazil, we are joined by Claudia Sender, who is the President of TAM.

We will begin the presentation, if you go to -- sorry, I also want -- we are just being joined by Alvaro Carril, who is in charge of the cargo operations. If you turn to the slides on our webcast presentation, looking at the first slide that we have, we want to first mention that during the second quarter we obviously have a lot of updates and a lot of news, but we have made significant progress on various different strategic fronts as we continue to consolidate our leadership position in Latin America.

This includes the launch of our new brands; it includes the completion of a couple of important financing transactions; the continued development of our hubs; and important progress in terms of our cost efficiency and cost reduction program. Nonetheless, as you know, during the quarter we

have seen the macroeconomic situation in Latin America become increasingly more challenging, especially in Brazil. And this has impacted our results and is visible, as you can see in our second quarter numbers, by declines, especially on our total revenue lines in both the passenger and the cargo operations.

When we look at the situation in Brazil, we have numbers that have gotten increasingly worse. We are seeing today estimates of approximately 1.5% declines in GDP inflation at over 9%, and continued devaluation and continued volatility of the Brazilian currency. So all of that has resulted in the airline industry in Brazil as a whole suffering from declines in demand. As a result, we have made certain adjustments to our domestic network, which we have already announced. And we have also reduced our guidance for the year in terms of EBIT margin, which we also discuss in more detail, but we have basically published a reduction in our expected EBIT margin for the full-year 2015.

I think it's important to note that we have seen outside of Brazil that our operations continue to show improved profitability versus last (technical difficulty). We have seen some impact obviously on the revenue side from currency devaluation, but we have also seen a benefit from cost efficiencies and fuel price reductions. So as a whole, these improvements in profitability have allowed us to offset in part the negative effects of what we are seeing in Brazil.

If you turn to slide number 3 of the slide deck, this is a summary of the numbers that we published for our second quarter results. Basically, we have seen a significant decline on the revenue side. Revenues are down 20.8% in the quarter compared to last year: 21.8% on the passenger side, 21.3% on the cargo side. This is offset by a very significant reduction on the cost side of also 21%. That cost reduction is being driven by lower fuel costs as well as by our cost efficiency initiatives and by the positive effect that we have from the devaluation of local currencies on our costs that are denominated in local currencies. As a result of all of that, our operating income is up 12%. In the quarter, our operating margin is showing a slight improvement versus the second quarter of last year, and our net income is -- our net loss, let's say, is lower than what it was in the second quarter of last year.

If we turn to the next slide, which is slide number 5, we can look a little bit in more detail at the passenger revenue line. What we can see here is that, overall, our capacity was up during the quarter 2%. That was driven mainly by growth in the Spanish-speaking country domestic operations. Those are the five domestic operations that we have outside of Brazil. And also by a 3% growth on the international routes. When we look at international operations, our capacity is up 3%. Traffic is up 2.1%. Load factors are very strong at 84.5%, and we have seen a decline of 15.9% in terms of revenue per ASK, most of which is being driven by a decline on the routes to and from Brazil, both on long-haul and regional operations.

When we look at the domestic Brazil operations, which is approximately one-third of our total capacity, we have cut capacity during the second quarter in domestic Brazil by 0.5%. Our load factors are 79.5%, and our revenue per ASK decline is 34%. That 34% is in US dollar terms. If we look at our revenue per ASK decline in Brazilian reais, the decline is 12%. That's driven mainly by a decline in the corporate demand, corporate travel demand and a -- in addition to that, we have the 36% devaluation of the Brazilian real, on average, during the quarter, which obviously impacts the number when we look at it in US dollar terms.

When we look at the five countries that make up our Spanish-speaking domestic operations, there we are growing at a rate of 4% in the second quarter. That growth is being driven mainly by a growth in Peru and in Colombia. And overall there come our revenue per ASK decline is 7%, which is basically fully explained by the devaluation of the local currencies, especially in Chile, Peru, Colombia, and Argentina. In Chile, Peru, and Argentina, the devaluation of the currencies versus last year is in the range of 10%, on average. In Colombia we had a very strong devaluation of 28% in the quarter. When we look at the revenue per ASK in local currencies, the revenue per ASK is improving in Chile and Peru and Argentina and in Ecuador. So, in these markets, we are seeing improved profitability with respect to what we had in the same quarter of last year.

Turning to the cost side, as you know and as we've already announced, we are working on a very significant cost efficiency program. Our target there is a reduction of \$800 million in terms of total costs to be achieved during the next three years to reach the run rate by 2018. What we've seen in the second quarter is in line with our target in terms of this cost-saving plan. If we look at our total costs for the second quarter, you can see that we had a 14% reduction of costs on the wages and benefits side. This was driven by a 1% reduction in our average headcount for the quarter, which is about 570 FTEs lower on average than what we had in second quarter 2014. And this is despite the fact that we grew in ASKs 2% in the second quarter compared to last year.



On the aircraft cost side, we have costs remaining relatively flat. We have reductions in depreciation cost and reduction in aircraft rentals and slightly higher costs on the maintenance side, mainly driven by the redelivery of certain aircraft during the quarter. And then in terms of all the other costs, we have a total reduction of approximately 21%, where we are seeing a portion of this driven by the devaluation of the local currency, which reduced the costs denominated in local currencies by reduced sales costs and reduced rental and lending fees as well. So overall, if we look at our total operating cost ex-fuel we see a very significant reduction of almost 14% during the quarter in terms of total cost per ASK equivalent.

In addition to that, we have the benefit of lower fuel costs. Fuel costs were down by approximately 34%, which was a total savings of \$637 million in the second quarter compared to our fuel bill in the second quarter of 2014. Sorry -- of \$352 million compared to the fuel costs that we had last year. So with that, our total operating cost per ASK-equivalent was down almost 21% in the quarter.

We wanted to mention briefly an update in terms of our strategic initiatives that we have already mentioned. Part of it has to do with the cost reduction, which I think we've already discussed. But I also wanted to talk a little bit about the progress that we've made in terms of our customer experience and the focus that we have on improving and continuously improving the customer experience of LATAM Airlines Group, and also in terms of the development of our network. Turning to page 8, you can see that we continue to strengthen our network and we continue to focus on providing our passengers with the best connectivity within South America, as well as traveling to the region and from the region abroad.

To that end, we have launched a series of new routes during the second quarter and we have also announced new routes during the second quarter to be flown over the coming months. These routes, which are here on the slide, are basically focused on strengthening the hubs that we have. At Lima, the Brasilia hub, where we have added flights from Brasilia to Orlando and Brasilia to Buenos Aires in recent months. And also our main hub at Guarulhos Airport in Sao Paulo. And with this, our objective continues to be to strengthen the network and to build the strongest network in South America.

A very important milestone that we had a couple of weeks ago and that has made us very happy to finally announce the new brand, which is -- we announced on August 6. And this is -- we are unifying the LAN and the TAM brands under a single brand, which is LATAM. This will be a gradual process that will take place over the next three years, but you will see during next year, during 2016 especially, already the phasing out of the LAN and the TAM brands. And you will see LATAM appearing at airports, at airport counters and sales offices, and basically in different points of contact where the Company operates, as we gradually phase out the LAN and TAM brands and establish LATAM as a single brand for the Group. This new brand will include the most valued strength and the main attributes that LAN and TAM have built over their respective history.

Turning to page 10, we also wanted to mention the progress that we've made in terms of launching new aspects of our passenger experience and the continuous improvement that we are making in terms of our passenger experience. We have unified the counters to have single check-in already at 10 of the main airports where we operate. So we have -- you no longer have separate check-ins for LAN and TAM, but a single counter where you can check-in for both LAN and TAM. We also are testing a self-service Self-Bag Tag for a faster bag drop process at two main airports in Brazil.

In terms of digital solutions, for contingency management we've launched Live Chat and a flight status app. And we have also continued with installing the wireless in-flight entertainment system for personal devices. We already have this installed at 68 of our A320s, and we expect all of our A320 fleets to have this in operation by the first quarter of 2016. Also, very significant is the improvement in terms of on-time performance that we continue to see throughout our network, especially if you look at our domestic Brazil operations. We are at record levels in terms of punctuality with a 15-minute standard. Including all of the domestic operation in Brazil, the punctuality levels are almost at 91% with a 15-minute standard. They are at approximately 90% in the Spanish-speaking countries and close to 85% in all of our international networks.

Regarding our hedging strategy both for fuel and for FX, we currently have hedged approximately 42% of our estimated fuel consumption for the next 12 months, so this is for the period between July 2015 and June 2016. With the breakdown that you can see there on the quarter, we are 50% hedged for the second semester of this year in terms of our estimated fuel consumption. And then on a declining basis for the next -- for the first quarter of 2016 as -- and reaching a 10% hedge for the last quarter of 2016.



Regarding our exposure to FX we have, as you know, more revenue than costs denominated in Brazilian currency. Therefore, we have a long position, so to speak, in terms of Brazilian reais when we look at the exposure of our operating results to the devaluations of that currency. We hedge the totality of that exposure. We have \$310 million hedged for the second half of this year, at an average of BRL3.20 per dollar.

During the second quarter, we completed two important financing transactions. We issued our first unsecured bond for \$500 million. And we also completed the issuance of a \$1 billion EETC issuance to finance aircraft deliveries until March of 2016. With that, we have financed approximately 57% of our fleet commitments for 2016 and we've also improved our leverage ratio and cash position, as you can see here on the slide. We are currently at a net leverage of 5.1 times and our cash is approximately 14% of last 12 months' revenue.

Looking at our fleet plan which is on slide number 13, you can see the fleet plan that we have for this year. We expect to end this year with 329 jets and for next year, 2016, to end the year with 336 aircraft. Basically, this fleet plan is relatively unchanged. I think there's a slight reduction in terms of our total fleet commitments versus what you saw last quarter for 2016, mainly as a result of the delayed delivery of four aircraft into 2017. But other than that, the fleet commitments remain more or less the same.

We have a significant turnover of aircraft. What we're doing is phasing out older aircraft in our fleet and incorporating newer and more modern and more efficient aircraft. So here you can see that we are growing from 21 A321s to 48 A321s in 2016, and we are growing from 10 787s that we had at the end of 2014 to a total of 22 787s, and also seven A350s at the end of 2016. So, a significantly higher proportion of our fleet will be newer and more efficient aircraft, which is also resulting in a lower and more efficient fuel consumption for the Company. And also in an improved passenger experience, as these aircraft come with the renewed cabin interiors and also with the unified interior cabin that we have defined for LATAM Airlines Group.

Finally, the last slide shows you our current guidance. The main change here in terms of passenger capacity growth has to do with a reduction in our Brazil domestic capacity guidance. We were previously expecting to be flat for 2015 in terms of total capacity, and our current estimate is to have a reduction of between 2% and 4% of our ASKs in the domestic Brazil routes, which will occur mostly in the third quarter and in the fourth quarter, reaching up to an 8% to 10% reduction in the fourth quarter versus last year levels.

Our capacity guidance for the international on the Spanish-speaking countries remains the same. And our capacity guidance for cargo also remains the same, with an estimated reduction of up to 2%, driven mainly by the reductions that we are doing in our freighter capacity, offset in part by the growth that we are seeing in the bellies of the passenger planes as a result of the growth in international operations. Also here, and mainly as I mentioned earlier as a result of the outlook that we have for Brazil, we have reduced our operating margin guidance from our previous 6% to 8% to 3.5% to 5% for the full-year 2015.

That completes the prepared remarks that we had and we'll be happy to take any questions that you may have.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Bernardo Velez, GBM.

Bernardo Velez - GBM - Analyst

I was wondering, in trying to match -- I don't know if you saw the capacity guidance update by GOL, and to see how that relates to your capacity cuts. Meaning if competitors in Brazil continue dropping capacity in the upcoming months and probably into 2016, what should we expect from domestic capacity by TAM.



Claudia Sender - LATAM Airlines Group SA - President, TAM

Well, we cannot talk about competitors' strategies so -- this is Claudia by the way, sorry. I'm going to talk about our strategy. We have reduced capacity because we saw significant potential in some of the routes, and this is what we've done. And we're keeping -- we are maintaining our plan that we've announced three weeks ago. Of course, we are always flexible, looking ahead what's going to happen with the demand and with the overall market, but we believe that what we have announced three weeks ago is the right measure for how big the market -- or how big the demand is forecasted to be in the second quarter.

Therefore, we believe that there will be -- sorry, second half of 2015 -- but we believe that this will help us somehow fuel a recovery in yields. And because the demand will be much more -- the capacity will be much more matched to the demand.

Bernardo Velez - GBM - Analyst

Okay, perfect. And regarding the flexibility of your fleet commitments for 2016, could you comment on what changed from last quarter to this one? And what could continue changing if you decide to further reduce capacity in Brazil?

Roberto Alvo - LATAM Airlines Group SA - SVP, Network and Fleet

Sorry, the question is regarding fleet or capacity in particular?

Bernardo Velez - GBM - Analyst

The fleet commitments.

Roberto Alvo - LATAM Airlines Group SA - SVP, Network and Fleet

So with respect to last -- this is Roberto Alvo. With respect to fleet coming from last quarter to this quarter, we are basically for 2016 delaying three single-aisle aircraft and one widebody aircraft. We do not expect any other movements that are significant in 2016 or for 2017 and 2018 onwards, as actually was said in the press release. We are currently looking at delaying the delivery of a certain number of widebody aircraft that has yet to be defined. And if we end up doing this, we will communicate that to the market in time.

Bernardo Velez - GBM - Analyst

Okay, perfect. Thanks a lot for your help, Roberto.

Operator

Duane Pfennigwerth, Evercore.

Jeff Eisenberg - Evercore ISI - Analyst

This is Jeff Eisenberg in for Duane. On your margin guidance, I assume that some of that margin that you projected at 3.5% to 5% is tied to the domestic capacity cuts. Can you comment on where operating margin would be if not for the those contemplated cuts?

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Gisela Escobar - LATAM Airlines Group SA - Senior Corporate Controller and Director of IR

Well, it's not significantly impacted by the capacity cuts. As Claudia mentioned, the logic of doing the reduction in capacity is to better adjust the existing capacity to the current levels of demand. So, I think the main reason for the decline in guidance has to do with a weaker demand environment in Brazil as a result of the current macro scenario. And part of the response to that was our adjustment of capacity in the domestic market versus what we had previously planned.

Jeff Eisenberg - Evercore ISI - Analyst

Got it. And then I think you also mentioned that you had grown Colombia capacity in the quarter, and I think one of your competitors had described demand weakness and some of the same foreign exchange pressures. So, could you comment on if you experienced there that variance, or if Colombia trends are holding up for you guys?

Gisela Escobar - LATAM Airlines Group SA - Senior Corporate Controller and Director of IR

Well, the dynamic in the Colombian domestic market this year, the market in general has already last year posted a significant, double-digit growth in terms of capacity, and for this year also the industry as a whole is growing at levels of between 15% and 17% in ASK. So, we are in line with that and that has obviously led to some pressure on yields. And what we are seeing now, as of the last few months in addition to that, this growth was basically a response to an opportunity that the industry was seeing to grow capacity in this market, and what we had seen in Columbia was a very healthy demand level because of the economic situation in the country.

Now we are seeing a negative impacts in terms of our revenue per ASK in local currencies also as a result of the devaluation of the currency. The Colombian currency, as I'm sure you know, has devalued almost 30% in the second quarter. So we are looking at what impact that's going to have for our capacity growth plans for the second half. We may -- already in terms of on a comparative basis, we had a lot of growth in the second half of last year so the second half of this year will grow less than the growth that we had in the first half.

Then also I think it's important to mention that Colombia for us still is a very small domestic operation, still a relatively small part of our total network.

Jeff Eisenberg - Evercore ISI - Analyst

Great. If I could sneak one more in. At current levels, are you having any discussions or have any appetite to buy back stock?

Gisela Escobar - LATAM Airlines Group SA - Senior Corporate Controller and Director of IR

Well, in Chile, the stock buyback programs are not really a -- you can't implement them the way that you can in the US. There is certain restrictions in terms of being able to do stock buybacks. And also you can't do a stock reduction. So, if the Company does stock buybacks you have to do it for a specific purpose, and you can't reduce those shares. You have the obligation to sell them back into the market within a very limited time frame. So, unfortunately, it's not a tool that we can use in the way that companies can use in other markets.

Jeff Eisenberg - Evercore ISI - Analyst

Got it. Thank you very much for taking the questions.

Operator

Victor Mizusaki, Bradesco.



Victor Mizusaki - Banco Bradesco - Analyst

I have a couple of questions on yields. First, can you give more granularity on what happened with yields in the second quarter? I mean, if you can give a breakdown on what happened in April, May, and June. And given that you already released your tax figures for July, can you comment on what happened in July with the yields and what we -- what you can see in your forward-booking?

Gisela Escobar - LATAM Airlines Group SA - Senior Corporate Controller and Director of IR

Victor, do you mean Brazil overall? Do you have any specifics?

Victor Mizusaki - Banco Bradesco - Analyst

Yes, Brazil.

Gisela Escobar - LATAM Airlines Group SA - Senior Corporate Controller and Director of IR

Of course. All right so, what we have seen -- I'm not going to break it down by month, but I'm going to tell you a little bit of the trend that we've been seeing. July is a month where we finally start seeing a slow pickup. I think it's too early to say that it is a structural recovery in the level of yields, but we have seen some pickup in the last weeks of July and the first week of August. So we believe that it could be -- it could potentially be a trend.

Victor Mizusaki - Banco Bradesco - Analyst

Okay. And if you think about international, for example is there any specific month in the second quarter that was real weak and forced the Company to reduce guidance for the full year?

Roberto Alvo - LATAM Airlines Group SA - SVP, Network and Fleet

No, there is no significant difference between the months in the quarter, and the dynamics of yields are pretty much the same that you see in domestic Brazil. The situation in Brazil is an industrial situation, more than an issue of domestic versus international.

Victor Mizusaki - Banco Bradesco - Analyst

Okay. And just a last question, because we feel these capacity reduction basically -- I mean, the Company is expect that yields will have a positive reaction, right? I mean you do rebound in the second half. But is there any plan for LATAM if yields did not respond?

Claudia Sender - LATAM Airlines Group SA - President, TAM

Victor, I think we are following the market very closely. As I said before, we do believe that the adjustment that we've announced will be enough to adjust capacity to current levels of demand. Of course, there's so much uncertainty in the market that we have to be flexible and agile to respond to any changes that happen. So, if the market happens to pick up and we have a higher level of confidence in the market, we can respond quickly and we are able, because we are such a big group, we have some more flexibility to respond to that level of demand quickly. And on the other hand, if the market continues to deteriorate further than what we've announced, we also have the flexibility to change what -- to adjust more the capacity to the demand. However, we don't think that this will be necessary in the short term.



Victor Mizusaki - Banco Bradesco - Analyst

Okay. Thank you.

Operator

Mike Linenberg, Deutsche Bank.

Mike Linenberg - Deutsche Bank - Analyst

Just a couple of questions here. I guess to Claudia, the capacity cut this year, domestic Brazil of down 2% to 4%. By the fourth quarter it's down 8% to 10%. I want to just confirm, is that -- when the press release came out a few weeks ago and it talked about you cutting your domestic footprint in Brazil by 8% to 10%, will we be there by the fourth quarter? For some reason I thought it was going to be more gradual and it would occur over several years. But it sounds like we are going to be there by the fourth quarter. Is that right or am I interpreting that correctly?

Claudia Sender - LATAM Airlines Group SA - President, TAM

Yes, we will get to 8% to 10% by the fourth quarter of this year. We have already, if you look at the schedule that we've published for the next few months, it is gradual. We've been decreasing capacity month over month, and this is the level that we will achieve by the end of the year. Having said that, I think it's important to remind a few things that we have mentioned when we announced the capacity cut. First, we were not -- we're not leaving any of the bases that we -- or the airports that we currently serve, so we are still covering the same percentage of the domestic flows. And second, we are leveraging our most important hub, which is Brasilia. Therefore we can still guarantee a very, very efficient coverage of the domestic flows. So, although we are reducing our capacity, our overall capacity, we are still leveraging one of our key assets, which is the connectivity through the Brasilia hub.

Mike Linenberg - Deutsche Bank - Analyst

Okay. And then just -- when I think about 8% to 10% by the fourth quarter and it's gradual, for 2016 your domestic capacity in Brazil, just rough numbers because it's sort of occurred through this year, or the latter part of this year, are you going to be down what, 5% to 6%? Is that kind of the right range to think about how much smaller your next year in Brazil?

Claudia Sender - LATAM Airlines Group SA - President, TAM

We are still working on that forecast. We're not ready to release that forecast for next year yet, I'm sorry.

Mike Linenberg - Deutsche Bank - Analyst

Okay, not a problem. Just a last question and maybe, Gisela, this is for you. I look at the market values of Multiplus and Smiles, and you look at the market cap of the airline, and you can see just such a huge disconnect out there. Have you -- is there a point where you start rethinking LANPASS and where LANPASS fits in all this? And especially if you are now moving to a single brand, the LATAM brand, where do things stand now as it relates to the TAM Fidelidade and the LANPASS program as you move to a single brand? Do we see any sort of combination there? Just your thoughts on it.



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Roberto Alvo - LATAM Airlines Group SA - SVP, Network and Fleet

Mike, this is Roberto Alvo. Of course we're always looking at different alternatives for doing several things at the Company. At this moment we have not changed our decision into how we will continue with both Multiplus and LANPASS. We are increasingly merging the features of our -- both frequent-flier programs. So, during the course of the second semester and into next year, some of the features will be harmonized. But we'll still have two coalitions for the time being and two frequent-flier program names.

Mike Linenberg - Deutsche Bank - Analyst

Okay. And then if I could just squeeze in one last one, where are we on the front of -- as we move toward open skies, US and Brazil, that kicks in I think in the next couple of months. I think it's October. I could be wrong. Have you put out any sort of -- have we seen any sort of press releases or is there anything going on with you and American and about potentially seeking antitrust immunity?

Claudia Sender - LATAM Airlines Group SA - President, TAM

Mike, as we mentioned, we are still waiting from for the rectification from the Brazilian government about the open skies agreement, which should happen by October. That's the deadline. So we are waiting for that until we can announce anything.

Mike Linenberg - Deutsche Bank - Analyst

Okay. Great point. Thanks, Claudia. Thank you.

Operator

Renato Salomone, Itau BBA.

Renato Salomone - Itau BBA International - Analyst

Thanks for taking my question. On the international market, we haven't seen by the industry, especially between Brazil and the US, any adjustments in capacity. And when I look -- you've added, if I'm not mistaken, in the first half of the year about 2.5% ASK in the international market, and your guidance of 4% to 6%. Is there any chance that you revise that as well? Does that concern you that the market is not adjusting in the US -- in routes between Brazil and the US?

Roberto Alvo - LATAM Airlines Group SA - SVP, Network and Fleet

This is Roberto Alvo. A couple of things. First, I think it's important to see what the airlines were announcing six months ago or a year ago in terms of growth in Brazil, and what they are publishing today. So, yes, there hasn't been a decreasing supply. But I think there has been a significant decrease in the growth that was projected into Brazil for 2015. So, the adjustment is probably not with respect to the base but definitely with respect to future plans of many carriers. The 4% to 6% remember, it's the whole international passenger business, which has approximately 50% of its capacity in Brazil and 50% of its capacity outside Brazil. So here you are looking at the blended number between what we expect to grow in both Brazil and outside Brazil. So, we are confident and we don't see that we need to make an important change to the guidance we've made of 4% to 6% at this point in time.

Renato Salomone - Itau BBA International - Analyst

Okay. And in the international, what do you have of aircraft -- widebody aircraft deliveries scheduled for the remainder of the year and for the first half that you won't be able to change? That there's nothing you can change?



Roberto Alvo - LATAM Airlines Group SA - SVP, Network and Fleet

I will not comment on our ability to change. I will tell you the deliveries we have, we still have pending three 787-9 deliveries and the first A350 delivery by the end of the year. And then next year we have six A350 deliveries and five, I think, 787 deliveries. We are phasing out all of our 330 fleet. Today we have ten 330 airplanes. So in terms of number of total airplanes, we are basically flat.

Renato Salomone - Itau BBA International - Analyst

Okay, thank you. And a quick follow-up, can you -- you mentioned the percentage of a fuel consumption hedge. Can you give us the average prices you have for the second half of the year and for 2016?

Andres del Valle - LATAM Airlines Group SA - Corporate Finance Director

No. Andres del Valle here. We typically we do not provide the prices that which we are hedged, because of course of market reasons.

Renato Salomone - Itau BBA International - Analyst

Okay. Thank you.

Operator

Stephen Trent, Citigroup.

Stephen Trent - Citigroup - Analyst

Thanks for taking my questions. Most have been answered, but just a few follow-ups, if I may. Forgive me if I missed if you've already said this, but on Brazil, understanding that the capacity drawdown that you guys mentioned -- have you any further color as to where you are going to redeploy that? And if you are allowed to tell me if some are going to be subleased or you are going to put them in other markets, and what's the idea there?

Roberto Alvo - LATAM Airlines Group SA - SVP, Network and Fleet

This is Roberto Alvo again. So, just a couple of comments on that. We have significant wide -- single-aisle flexibility in terms of fleet. So, approximately 5% to 7% of the fleet expires every year or is phased out because of aging. So, we retain a high degree of flexibility of either returning planes or maintaining those planes as we go ahead. And we also have an important level of flexibility between moving aircraft from the TAM side to the LAN side by switching operations as we do currently today with both carriers. So, we don't see any -- we don't have any particular concerns with respect to our single-aisle fleet flexibility given -- or issues, given the flexibility we have.

Stephen Trent - Citigroup - Analyst

Okay, very helpful. And with respect to the fleet, I recall that you guys were in this phase for a while to take the TAM aircraft and move them onto the balance sheet in Santiago. And could you just refresh my memory, where that stands?



Andres del Valle - LATAM Airlines Group SA - Corporate Finance Director

Yes, we have made a significant improvement on that front. I think the balance sheet that -- TAM's mismatch on the balance sheet driven by availabilities is down to below \$1 billion. So I think we have moved already the majority of the aircraft at those financed leases, commercial financings, and [ECA] financing. And still a few aircraft to be moved up, but that we are in the process, and the process is expected to be completed within this year.

Stephen Trent - Citigroup - Analyst

Okay, great, thank you. And just one last question, and it might be a question for Claudia. Sorry to bombard you here, Claudia. Just curious, the Brazilian airlines have been fairly active the past several quarters this ABEAR Association -- I'm probably mispronouncing it. And now we are seeing potential changes in payroll taxation and PIS-Cofins and what have you, and any sort of broad color how active ABEAR is in having discussions with the government? Or is the current situation just too volatile -- that the dialogues -- declines versus where it was last year or the year before?

Claudia Sender - LATAM Airlines Group SA - President, TAM

Hi, Stephen. You pronounced it correctly. It's ABEAR. But the Association has been fairly active, I think as all of the industry entities have been trying to somehow mitigate the impact of the new taxation. And I think we've been quite effective on that. It's still too early to tell, though. All of the measures that you've mentioned are still going through Congress, so it's kind of hard to understand what will be the final picture. But what we are trying to do as an industry is to calculate and expose and explain in a fairly simple way what is the impact that this has on us, in a moment where there are so many macroeconomic variables that are also in place.

I think one of the examples of how ABEAR has been very effective is in the definition of what we call the labor run-out, or the crew productivity revision log, where we have come to an agreement with the union through Congress to a much more palatable regulation going forward. Which is also still transiting through Congress and still yet to be defined, but at much more reasonable terms than the original proposition that we had on the table.

Stephen Trent - Citigroup - Analyst

Okay. Very helpful. Appreciate that, Claudia. I'll let someone else ask a question. Thank you.

Operator

Daniel Guardiola, LarrainVial.

Daniel Guardiola - LarrainVial - Analyst

Good morning to all. I have a very quick question. I would like to touch on the fleet commitments. I saw in your second Q 2015 report that 2016 commitments were cut by \$340 million. And I would like to know if you could please comment with us from which sources are you expecting to fund the \$2 billion commitments for 2016 in an environment of depressed yields? Thank you.

Roberto Alvo - LATAM Airlines Group SA - SVP, Network and Fleet

For 2016, as the press release commented, that we have already financed 57% of that total. Those are the commitments. Roughly 50% of that would be done through operating leases, 50% of that through finance leases. So what's yet to be financed for 2016, it's approximately \$1 million, and we've already issued ERPs for the operating leases. And in the next two or three weeks we will launch our RFP for finance leases. And the first that

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could be financed, which is not financed yet, is deliveries in April next year. So we have, number one, ample time to do those financings. And number two, we have all the markets open, both our capital markets, [ECH port] loans, and commercial loans as well.

Daniel Guardiola - LarrainVial - Analyst

Thank you. And just a follow-up regarding that. If necessary, how much could you further cut these commitments for 2016?

Roberto Alvo - LATAM Airlines Group SA - SVP, Network and Fleet

How much up, I'm sorry?

Daniel Guardiola - LarrainVial - Analyst

By how much could you further cut the commitments for 2016?

Roberto Alvo - LATAM Airlines Group SA - SVP, Network and Fleet

I think we already commented on the flexibility for 2016. What has been said already, that we postpone three narrowbody, or kept one widebody aircraft. This is what we've done so far and we cannot comment further on 2016.

Daniel Guardiola - LarrainVial - Analyst

Okay, great. Thank you.

Operator

Marcio Prado, Goldman Sachs.

Marcio Prado - Goldman Sachs - Analyst

Thanks for the call. I would just like to make a quick follow-up question on the jet fuel hedge. I heard you comment that you are not going to comment on the average price. However, we have seen a large increase in terms of the hedging levels. If I'm not mistaken in first Q the Company was at around 30% to 35%. Now the Company is at above 40%. So can you comment on the timing with regards to the implementation of this increase in the hedging levels, if this was spread throughout the second quarter, or if in fact not only second quarter but also third quarter? Thank you.

Andres del Valle - LATAM Airlines Group SA - Corporate Finance Director

I think for the third quarter of this year, we (technical difficulty) the last legacy hedge that we -- was taken at the year before. And for this year, as was just commented, we have a total for the next -- from today through Q4 of next year, 2016, the total is roughly 33% of our consumption hedged. For this year it's roughly 50%. Of the next 12 months it's roughly 40%. This is in line with the current policy, of which we typically have for the nearby quarter which is in front of us. 50% of consumption hedged, and then on a declining scale going forward. So, it's something we have seen substantial -- I mean changes in level of hedging policy. That's just roughly the same as we have done in the past.

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Marcio Prado - *Goldman Sachs - Analyst*

Just on the front, what is the hedging level in first Q that you have disclosed for the next 12 months? Wasn't it close to the 30% level? Just that's why I mentioned the higher hedging levels.

Gisela Escobar - *LATAM Airlines Group SA - Senior Corporate Controller and Director of IR*

Yes, I think your point is that we have taken a lot of these hedges, especially the 2016 hedges, during the past three months. That is correct.

Marcio Prado - *Goldman Sachs - Analyst*

Okay, thank you.

Gisela Escobar - *LATAM Airlines Group SA - Senior Corporate Controller and Director of IR*

And that's in line what Andres was mentioning, it's in line with our policy of always looking to hedge out for the next four or five quarters. So we have seen now, during the past three months, the opportunity to start building our position for -- out until the fourth quarter of 2016.

Marcio Prado - *Goldman Sachs - Analyst*

Thank you.

Operator

Ricardo Fernandez, EuroAmerica.

Ricardo Fernandez - *EuroAmerica Financial Services - Analyst*

Yes, thank you. A very brief question. If we assume (technical difficulty) (multiple speakers).

Operator

Ricardo, your line is breaking up.

Ricardo Fernandez - *EuroAmerica Financial Services - Analyst*

Yes, well, I can't help that. It's whatever it is. Can you hear me now? Can you hear me?

Gisela Escobar - *LATAM Airlines Group SA - Senior Corporate Controller and Director of IR*

Yes, we can hear you.

Ricardo Fernandez - *EuroAmerica Financial Services - Analyst*

Hello?

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Operator

Go ahead.

Gisela Escobar - LATAM Airlines Group SA - Senior Corporate Controller and Director of IR

We can hear you.

Ricardo Fernandez - EuroAmerica Financial Services - Analyst

Okay. The question is, if we assume the low-end of the guidance range, 3% EBIT margin, and you make -- will that allow you to maintain your CapEx, your funding, even into 2016, assuming a very low margin? Or do you think you will need to do something on either capital raise or asset sales?

Gisela Escobar - LATAM Airlines Group SA - Senior Corporate Controller and Director of IR

No, we don't foresee the need to do that at this point. As Andres mentioned, we have already financed more than half of our fleet commitments for 2016. And the remaining are already in process.

Ricardo Fernandez - EuroAmerica Financial Services - Analyst

Okay. So even at the low-end of we'll call it cash generation 3% or so, you are confident that you can go through the end of 2016 with the CapEx (technical difficulty) in half?

Gisela Escobar - LATAM Airlines Group SA - Senior Corporate Controller and Director of IR

Yes.

Ricardo Fernandez - EuroAmerica Financial Services - Analyst

Okay. Thank you very much.

Operator

And I'm not showing any further questions. I will turn the call back to Mr. Gisela Escobar for any final remarks.

Gisela Escobar - LATAM Airlines Group SA - Senior Corporate Controller and Director of IR

Well, thanks everyone, for your participation in today's call. If you have any follow-up questions, we are available here at LATAM and through the IR department to take any questions you may have. Thanks a lot and have a good day. Bye.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This concludes the program and you may all disconnect. Have a wonderful day, everyone.

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