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LAN.SN - Q4 2016 Latam Airlines Group SA Earnings Call

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CORPORATE PARTICIPANTS

Ramiro Alfonsin *LATAM Airlines Group - CFO*

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

Claudia Sender *LATAM Airlines Group - President of LATAM Brazil*

Roberto Alvo *LATAM Airlines Group - SVP of Network and Fleet*

CONFERENCE CALL PARTICIPANTS

Savi Syth *Raymond James - Analyst*

Mike Linenberg *Deutsche Bank - Analyst*

Pablo Dabovar *GBN - Analyst*

Ricardo Alves *Morgan Stanley - Analyst*

Ravi Jain *HSBC - Analyst*

Renato Salomone *Itau - Analyst*

Victor Mizusaki *Bradesco BBI - Analyst*

Magdalena Santana *Citi - Analyst*

Rene Pavez *Santander - Analyst*

PRESENTATION

Operator

Good day, everyone, and welcome to LATAM Airlines Group earnings release conference call. Just a reminder, this conference is being recorded. LATAM Airlines Group earnings release for the period was distributed on Wednesday, March 15. 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 the statements regarding the Company's business outlook and anticipated financials and operating results constitute forward-looking comments. These expectations are highly dependent on the economy, the airline industry, and the international market. Therefore, they are subject to change.

Now it is my pleasure to turn the call over to Mr. Ramiro Alfonsin, Chief Financial Officer of LATAM Airlines Group, for opening remarks and introduction. Mr. Alfonsin, please begin.

Ramiro Alfonsin - LATAM Airlines Group - CFO

Thank you, Crystal. Good morning, everyone, and welcome to LATAM Airlines fourth-quarter earnings call. Joining me today is Ms. Claudia Sender, President of LATAM Brazil; Ms. Gisela Escobar, Head of Corporate Control and Investor Relations; Mr. Roberto Alvo, Head of International Passenger Operations and Fleet; and Mr. Andres Del Valle, Head of Corporate Finance.

We're very happy to report a positive net income of \$69 million for the full-year 2016, the first year of positive bottom line since 2011. These results reflect the efforts the Company has made on several fronts, including strengthening our network, increasing efficiencies, and improving customer experience. Specifically, in 2016, our operating income increased by 10% year over year, driven mainly by cost discipline initiatives.



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Year 2016 was challenging for LATAM with weakening regional economies, a recession in Brazil, and high inflation rates in certain countries. Despite this macro environment, we improved our margins and started to deleverage the Company, all this while we received fleet in the amount of \$1.9 billion.

In addition, we launched a new business model for our domestic operations, we concluded a capital increase in which Qatar acquired 10% of LATAM's total share, and we continued working on reducing our fleet commitments for the next years.

I would like to inform you that yesterday the Company has announced that Mr. Ignacio Cueto will leave his management position in the Company and will be proposing himself as board member in the next shareholders meeting.

This is part of the initiative the Company is undergoing to have a leaner and more efficient organization. Mr. Enrique Cueto will continue to lead the Company as CEO. Now please join me on slide 2 where you will find the highlights of the fourth-quarter 2016 results.

Our earnings report, interest, and tax amounted to \$195 million, representing an operating margin of 7.6%. This is an increase of 1.4 percentage points if compared to fourth-quarter 2015 and includes \$121 million of nonrecurring costs mainly related to the rightsizing of the Company.

The improvement in operating results was driven by a 6.7% increase in total revenues as a result of an increasing passenger revenues after nine consecutive quarters of decline.

This improvement in revenues consolidates and further improves the positive trend in revenue per ASK we saw during the third quarter, reflecting in part an improvement in the Brazilian macro environment and the appreciation of its currency.

As you know, we reduced capacity in both domestic and international market in Brazil by 13% and 36% respectively. As a result, domestic RASK increased almost 15% in real terms during the fourth quarter and 35% in dollar terms.

However, RASK in Brazil remains below historical values, and therefore, we continue to take a cautious approach in Brazil with respect to capacity.

We have continued our efforts to adjust our fleet commitments. LATAM is reducing fleet commitments for 2018 by \$1 billion. With this, the Company will have reached a \$2.2 billion reduction in fleet assets for the period 2016-2018, in line with our plan.

More importantly, we will have two consecutive years of record low investments in fleet, which in approximately \$500 million each year. Almost 25% of the fleet received in 2016. This will contribute to our cash flow generation and to continue the deleveraging process we have initiated.

Regarding LATAM's financial situation, we improved our leverage, reaching 5.3 times adjusted net debt to EBITDAR that compares to the 5.8 times in 2015. Furthermore, our cash position reached \$1.8 billion, including an undrawn committed credit facility. Liquidity amounted to 19% of revenue and was bolstered by the \$600 million capital increase that was completed in December 28.

Turning to slide 3, you will find a summary of our income statements for the quarter on the left-hand side and for the full year on the right-hand side.

Although the environment is still challenging in most of our region, the fourth-quarter consolidated the positive trend we saw in the third quarter. Our revenues continued to show sequential improvements with the strong recovery on passenger revenues as a result of a more stable currency environment, as well as RASK improvement in domestic and international goods in Brazil.

Our costs increased by 5% if compared to the fourth-quarter 2015, and all of this increase is explained by nonrecurring costs of \$121 million associated mainly to fleet sales with deliveries and severance payments. Although the Company continues with the implementation of its ongoing cost reduction initiatives, the increase in unit costs this quarter reflects the negative impact of high inflation rates in the region, the appreciated local currencies, and the 2.7% decline in capacity as compared to the fourth quarter of 2015.



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When we look at the results for the full year on the right-hand side, revenues decreased by 6% year over year, registering a decline during the first half of 2016 and increasing revenues by 3.4% during the second half of the year. The annual decrease in revenues was offset by a 7% reduction in costs, mainly by fuel and wages as a result of the net reduction of 4500 employees. Therefore, the Company improved its operating income by over 10% year over year with an operating margin reaching 6% that is 0.9 percentage points above the operating margin for 2015.

Our net income reached a total amount of \$69 million for the first time since 2011, and our EBITDAR showed an increase of 6.3% with a margin of 22%, which is 2.5 percentage points higher than compared to 2015, which is fixed to the resilience and the sustainability of our business model, even in tough macro conditions.

Before handing the call to Gisela for more detail on the fourth quarter, we would like to thank our customers to their continued support and express our commitment to provide the best connectivity and service in Latin America. Gisela?

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

Thanks. Good morning, everyone. If you turn to page 4 to continue with the presentation, looking at the performance of our revenues during the fourth quarter, you can see that overall passenger revenues grew by 7.6% compared to the fourth quarter of last year. This is a significant improvement over what we saw during the first half of this year where we were seeing revenue declines in the range of 15% year over year.

So we have seen a consolidation of the positive trend that we started seeing already in the third quarter.

This reflects an improvement in the macro situation, especially in Brazil, as well as a more stabilized Brazilian real, and it also is a result of our active capacity management during this year, especially on international routes where during the first half of the year, we were growing approximately 8%, but we saw this growth rate reduced towards the end of the year, partly as a result of adjusting to a weaker macro environment in Brazil. And, as Ramiro mentioned, we saw reductions of up to 36% on routes between Brazil and the US in the fourth quarter of 2016 compared to 2015.

Overall, throughout the network, we maintained very healthy load factors on all our routes. Load factor for LATAM as a whole reached 84.5%, which is 1.3 percentage points above the fourth quarter of 2015.

On international routes, which represents 54% of our total system capacity, load factors reached 86.3% with a healthy traffic growth at 4.4%. On the revenue per ASK side, we saw almost a 4% improvement in revenue per ASK, and this was driven mainly by an improvement on routes between Brazil and the US, somewhat offset by a declining revenues per ASK in the Spanish-speaking market.

In the domestic Brazil market, we continued with the capacity reductions that we implemented throughout 2016. Capacity in the quarter was down almost 11% with a very high load factors at 83%. As a result, we were able to see a significant improvement in the revenue per ASK. In reals revenue per ASK improved almost 15% in the first quarter, and when we include the appreciation of the Brazilian currency, in US dollars we saw an improvement of almost 35%. And when we look at these numbers for the full year, we actually ended the year with an improvement of 6.3% in revenue per ASK in local currency as a result of our very proactive management of capacity in that market.

On the Spanish-speaking domestic market, which are the other five markets where we have domestic operations outside of Brazil, here we continued to see capacity growth with stable load factors, and we saw a revenue per ASK decline that was much lower than the revenue per ASK decline that we saw in the beginning of the year, which was between 17% and 22%. This decline -- this revenue per ASK also actually shows a sequential improvement with respect to the revenue per ASK levels that we were seeing in the third quarter of 2016. We are seeing revenue per ASK here decline in all markets in local currency, except in Argentina, and that is mainly a result of weaker macro environments in most of the countries where we are operating, as well as an additional competitive pressure in certain markets.

As a result of this, when you look at our growth -- our ASK growth guidance for next year, we are being much more conservative with our ASK growth estimates for 2017. Overall, we have estimated growth in Spanish-speaking markets between 4% and 6% for 2017, and we are at this point expecting to be on the lower end of that range.



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If you turn to page number 5 to look at the cost side, here, overall, in our total costs increased by 5.2% in the fourth quarter compared to 4Q 2015. This number includes \$121 million of costs that are nonrecurring and that are related mainly to the rightsizing that we have been doing at that Company, mainly related to severance costs, as well as to fleet redelivery and fleet sales costs. If we leave aside the nonrecurring costs, our operating costs during this quarter would have been more or less flat compared to the fourth quarter of 2015.

When we look at this number on a cost per ASK equivalent basis, excluding the nonrecurring items, our cost per ASK equivalent is up 2.3%. And that is mainly a result of a reduction of 2.7% in our ASK equivalents, which are a reduction both on the passenger and on the cargo side, and this reflects a lag that we have in being able to adjust our cost structure quickly to a much smaller operation.

This also includes an impact of an exchange rate, which during the quarter appreciated with respect to the fourth quarter of 2015, which is a change in the trends that we were seeing in the first quarters of this year.

Going forward, we continue with our cost efficiency initiatives, especially as you can see, during 2016, we had significant headcount reductions year over year, almost 9% reduction in headcount which was approximately 4500 employees net during the year, and in addition to that, we continue with all the efficiency initiatives that are related to the implementation of our new domestic business model that also comes with an increased efficiency on a series of fronts.

Turning to the next slide, which is page number 6 in the presentation, here we are very happy to announce that we have reached the target that we had set and that we had provided for you at the beginning of last year. If you recall, we had targeted a reduction in our total fleet asset for the period of between 2016 and 2018 of between \$2 billion and \$3 billion. At this point, with all of the fleet restructuring that we have already accomplished over the past months, we have reached \$2.2 billion reduction in total fleet assets.

Of the \$2.2 billion, approximately \$1.9 billion are lower fleet commitments as reflected in the 2017 and the 2018 numbers that you can see on this slide, and approximately \$315 million are lower fleet assets on our balance sheet, mainly as a result of aircraft fleet deliveries or sales.

If you look at the 2017 number and the 2018 number, we are seeing historically low fleet commitments for the Company. We have \$469 million in 2017. This is no cash-out CapEx for 2017. So this year, all of these fleet commitments will be financed with leases or with sale and lease backs. And for 2018, this is new. We have not provided this number before. We are seeing a \$930 million reduction in our total fleet commitments for 2018, leaving us at similar levels to what we are expecting for this year. So it puts us in a very positive situation from the perspective of our investment plan for this year and next.

With that, on the bottom of the slide, you can see the total number of aircraft. We are -- at this point expecting for this year and next to be operating a fleet of approximately 300 to 310 aircraft. This in 2017 does not include seven aircraft that we expect to have under sublease to third parties. So during 2017 overall, we're expecting delivery of seven aircraft, and we will be redelivering 21 aircraft to end the year with 311 aircraft in operation.

If you turn to page number 7, it is important here to highlight that the significant improvement that we have in our balance sheet, despite what was a very challenging 2016 from a macro perspective, we were able to successfully deleverage the Company. Our leverage -- adjusted net debt to EBITDAR for 2016 ended at 5.3 times. This is driven by a reduction of \$450 million in our total gross debt, as well as by an increase of 6.3% in our EBITDAR, which reached \$2.1 billion for 2016.

On the liquidity side, we saw also a very strong liquidity position for the year, reaching \$1.8 billion, including the revolving credit facility, which is completely undrawn at the close of December. The liquidity number is obviously strengthened by the capital increase that we completed at the end of December of 2016, which was the \$608 million that were subscribed by Qatar Airways as a result of the agreement between LATAM and Qatar that was announced last year.

This improvement in our balance sheet also is recognized by the credit rating agencies, and we saw last week that Fitch reaffirmed our B Plus credit rating and improved the outlook from negative to stable.



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On the debt maturity front, if you look at the graph on the bottom of the page, you can see that for the coming years, we have a relatively more or less flat maturity schedule. And for 2017, we have \$1.5 billion in debt amortizations, which we expect at this point to be financed approximately half. We are evaluating alternatives for those refinancings. And we have, as you know, a \$300 million maturity of the (inaudible) bond that is coming due in April and which we expect to pay down with our cash flow generation.

Turning to page number 8, you can see our fuel and FX hedging portfolio. On the top graph, we have the fuel hedging structure. For the fourth quarter of 2016, we had 49% of our fuel consumption hedged, which was relatively at market prices, and it ended up generating \$4.4 million in gain for that quarter.

Overall, we generally hedged between 30% and 60% of our fuel consumption for any given quarter. So we are more or less within that range for the first half of 2017, already at prices that are more or less in line with current market prices.

If we look at the PRL side, we also hedge our exposure to the Brazilian currency. During the fourth quarter of 2016, we had \$90 million or \$90 million equivalent hedged, and that generated a loss of almost \$3 million that was recognized in our P&L. So, overall, our hedging portfolio for the fourth quarter of 2016 generated was basically breakeven with \$1.6 million of a positive effect.

We also wanted to mention the progress that we have made on the implementation of our new business model for the domestic operations, as well as on the implementation of our ancillary revenue initiatives, both of which we discussed somewhat during our third-quarter results conference call. And at the beginning of 2016, we implemented a cabin upgrade building, a system which is available for long-haul flights on wide-body aircraft. And as of mid-2016, we also started implementing a series of ancillary revenue initiatives for narrowbody operations. In mid-2016, we started selling the economy plus seats, which are the first three rows of our narrowbody aircraft. We also implemented homogenous luggage allowance in all of our Spanish-speaking domestic markets, which basically allows passengers to travel with one bag that was 23 kg as a maximum and with the option to pay for a second bag.

During November, we made the public announcement of the new business model that we will be implementing, and all of these elements of the ancillary model basically are a part of that. This new model seeks to reduce costs and have the most efficient cost space in order to be able to reduce fares. We have targeted a reduction in our base fares in some of our markets of up to 20% as a result of the efficiencies that we expect to achieve from this model. And with that, our target is to continue stimulating new passengers and leading to sustainable and profitable growth for the long term for the industry, where we estimate that we should be able to increase by approximately 50% our total passengers by the year 2020.

So far this year, we have introduced buy onboard service in two of our Spanish-speaking domestic markets. This was introduced in Colombia in mid-February, and it was introduced in Peru on all of our domestic flights in mid-March. This is -- it is a menu which is called (spoken in foreign language) LATAM, which provides a series of a -- of snacks and beverage options for purchase onboard. This buy onboard service will be rolled out gradually to the other markets during the coming months. And the rest of the implementation of this domestic business model we also expect to complete within the first half of this year in all of our domestic markets.

Finally, we just want to reaffirm the guidance that we have already provided for 2017. We are expecting a very moderate ASK growth this year in all of our international and domestic operations. Total ASK growth we target to be between 0% and 2%. On international routes, we are expecting between 0% and 2% growth on Brazil domestic routes.

At this point, we are expecting between 0% and a reduction of 2% as a result of the capacity reductions that were already implemented in 2016. And in the Spanish-speaking domestic markets at this point, we are expecting ASK growth between 4% and 6%.

On the cargo side, we continue to reduce capacity, mainly on the freighter side. And for 2017, we are expecting that reduction to be between 10% and 12%. With that, operating margins should improve with respect to what we saw in 2016 to a range between 6% and 8%, which is what we are currently targeting.

That concludes the prepared remarks that we had for you this morning, and as usual, we will be very happy to take any questions that you may have.



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QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Savi Syth, Raymond James.

Savi Syth - Raymond James - Analyst

I believe your guidance is based previously on \$64 rents and BRL330 exchange rates, and it feels like maybe revenue is performing well, maybe a better clip. And I was just wondering if things remain steady, it's going to -- you are actually tracking in at the high end of guidance. I realize there is much of the year left, but I was just trying to get a sense of maybe things tracking in maybe at the higher end of guidance?

Ramiro Alfonsin - LATAM Airlines Group - CFO

At this point in time, as you are saying, it's too early to say. We have seen some reduction on the fuel prices these past weeks, and we have seen a more appreciated currency, particularly in Brazil. But at this point in time, it is too early to say, Savi. I think we should stick with the guidance that we provided.

Savi Syth - Raymond James - Analyst

Thanks. And if I may ask, on the domestic and Spanish-speaking country side, the RASK declines did moderate. Is that easier comps, or is the competitive capacity issues that you've been seeing for a few quarters now, is that starting to diminish? I wonder if you could just talk a little bit more on what you are seeing there and maybe if that is getting better or worse or staying the same?

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

We are seeing, as I mentioned, an improvement sequentially. So we are seeing a revenue per ASK level is somewhat higher than what they were towards the end of 2016 than what they were at the beginning of the year. However, we still see pressure on revenues per ASK as a result of the demand environment in most of these markets that has been generally weakening.

In certain markets in addition to that, we have competitive pressures like in Peru, for example, where we have five players in the market, and we actually had a new player into the market at the end of 2016. So that put additional pressure on markets on prices on some routes. And during 2017, we will probably see additional new entrants in that market in particular as well.

So it's a mixture I think of both, although we are seeing -- as a result of this, we have obviously managed capacity. So I think that has mitigated some of the pressure that we have seen. If you look at the growth rate that we have, it is lower than what we had during 2016, despite the fact that we will be rolling out our new domestic model during this year. So we're being very conservative in these markets with respect to capacity as a result of the pressure on pricing that we are seeing.

I think it's still too early to say that we expect to see an improvement here. I think levels are better. Also, the currency has helped. We are seeing for this and for the fourth quarter in 2016, currency has actually appreciated for the first time during the year where in the first half of the year, we were seeing currency significantly depreciate. So that also impacts this number. But I think for 2017, we're still expecting a fairly weak demand environment in most of these markets, and that's what our capacity guidance reflects.



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Savi Syth - *Raymond James - Analyst*

That's helpful. All right. Thank you very much.

Operator

Mike Linenberg, Deutsche Bank.

Mike Linenberg - *Deutsche Bank - Analyst*

Just a couple here. Gisela, you talked about the new bag fee policy in the Spanish-speaking countries. I guess that was implemented last year. Where are we -- and maybe this is actually a question for Claudia. Where are we on with bag fees in Brazil? I know that -- I think that they were supposed to come into effect maybe this month or next month. Where are you on as a firm? Is that something that you are going to adopt that maybe you have already put it into place with initial price points? If you can discuss that, that would be great.

Claudia Sender - *LATAM Airlines Group - President of LATAM Brazil*

Yes, we have already announced some changes in the chance for contracts between companies and passengers was announced (inaudible) by the end of last year and went into -- started -- and were implemented, in fact, on March 14. However, there was a procedure by the federal judge here in Brazil (inaudible) suspending the charge for the bag for now. We believe this decision will be reverted. We have already announced how much we're going to charge for the first and second bag in excess luggage and what would be our policy for who is searched for what and what type of tariff, and we are waiting for the final judge's decision.

Mike Linenberg - *Deutsche Bank - Analyst*

Claudia, is that final -- is that imminent, or is that something that it could go on for some time before we get a decision there? It sounds like it could be soon.

Claudia Sender - *LATAM Airlines Group - President of LATAM Brazil*

We believe that we are hoping and working for that decision to be taken as soon as possible because we strongly believe that it's very positive for the passenger and deregulation of all tariffs in general increase competitiveness and not otherwise. So we have seen this already happening in other markets.

We have seen it happening here in Brazil when tariffs were deregulated. In a short space of 10 years, prices declined by 50%, and the number of passengers tripled in the domestic market. So we believe that the same type of benefit will happen again, and we are hoping that overall regulators in the country will understand that claim.

Mike Linenberg - *Deutsche Bank - Analyst*

Okay. Great. And then just if I can ask about -- I saw that recently the approval was granted for LATAM and IAG to commence their joint venture. What does that actually -- when does that start? Are you waiting -- is there any other jurisdiction that you need regulatory approval from?



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Roberto Alvo - LATAM Airlines Group - SVP of Network and Fleet

Hi, Mike. This is Roberto Alvo. We got approval from (inaudible) the antitrust authority in Brazil as per the JV with IAG only. We are still seeking approval for the same Joint venture in Chile and in Europe. So this is our very important first step, but we still have some authorizations to go, and we are still working with the authorities in providing all the information required so that they can make a right assessment on this particular deal.

And in the case of a JV with American, it is also undergoing the process of approval. We have not yet got approval from Brazil. We only got approval from Uruguay in this particular area. So it is a continuing process, and we expect to continue working with the regulators throughout 2017.

Mike Linenberg - Deutsche Bank - Analyst

Okay, great. And then just one last one here. I saw that some of the A350s that you are taking delivery of are -- those positions have been picked up by Qatar Airways, and they are going to operate the airplanes. From what I have heard, though, is that those airplanes I think came in your colors and configuration, and I guess Qatar is going to fly them into the Middle East with your colors. Is that right? And two, does that mean is this just a short-term temporary measure with the airplanes are going to come into the LATAM fleet? Can you just -- can you talk about that?

Roberto Alvo - LATAM Airlines Group - SVP of Network and Fleet

Yes, positions were not taken by Qatar. These were aircraft that we do delivery of during that year. What we agreed with them it is a short sublease between six and 12 months for them to operate. They will operate with our colors and with our cabin. They will operate with their cabin group, and it's basically a way of adjusting our capacity here and them having a need of more lift in the region of the world. So it's a short-term operation, and these airplanes should come back to our fleet during 2017 or 2018.

Mike Linenberg - Deutsche Bank - Analyst

But is there a possibility where during the off-peak season for you and the peak season for them that those airplanes could go back and forth, or is that just too difficult with wide-body airplanes?

Roberto Alvo - LATAM Airlines Group - SVP of Network and Fleet

You know what? We have been focused in making this first operation happened. I think it's beneficial for both of us, and I don't discard that we can look at other opportunities like what you mentioned going forward.

Mike Linenberg - Deutsche Bank - Analyst

Yes, no, it is a very smart move. Appreciate it. Thank you.

Operator

[Pablo Dabovar], GBN.

Pablo Dabovar - GBN - Analyst

Hello. Good morning. Congratulations on the results. Thank you for taking my question.

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Now could you give us some color regarding the competitive environment in Brazil? I believe (inaudible) is also cutting capacity in the market. But, on the other side, I think Azul and Bianca have capacity growth expectations of double digits. So what should we be seeing in these markets for the year?

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

Well, I can't comment on our competitor and its decisions regarding capacity since they have announced recently what is their forecast for the year. What I can comment on is that we have decided to take a cautious approach again for 2017 here in Brazil regarding capacity. I think when we look back for the results in the last quarter of 2016, we are confident that our capacity reduction strategy really paid off, given the rapid improvements that we were able to achieve. And this is the discipline that we intend to maintain in the following years. So our guidance is to remain more or less flat or reaching 2% capacity reductions during 2017.

What we've seen is -- and, again, in this change, what we have prioritized is making sure we are connecting the corporate markets and all of the restricted airports so that we don't give up on our critical slots or flights that would be hard to reintroduce after this reduction.

What we've seen in terms of macroeconomic development for the first semester seems to make sense to our strategies.

Pablo Dabovar - GBN - Analyst

Okay. Thank you. And my other question, could you give us an update on the grand unification process? Where are you? What should we be seeing throughout the year? Thank you.

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

Well, the main changes were -- all of our airport -- all of our main airports are already showing the unified brand. We still have a -- I think a minor signage in smaller airports that still needs to be modified, and that's going to be done gradually throughout the year. But I think today the LATAM brand is already very visible in most of our main locations, and we're in the process of changing all of our sales offices. And with respect to the aircraft, as we had already announced, what we're doing with the aircraft is painting them with the new colors gradually as they go into their seat checks. So that is a process that is going to continue all throughout 2017 with some aircraft even going into 2018.

And the final part is the uniforms, which is also something that we're going to see in the coming months rolled out in all of our operations.

The change in uniforms because today we are still on most of our operation operating on the LA flights with the land uniform and on the Brazil flights with the (inaudible) uniform. But the main costs related to this were particularly recognized. So, as we explained last year when we announced it, this change was done with the objective of doing it gradually, was to not take a significant cost related to doing a big bag.

Claudia Sender - LATAM Airlines Group - President of LATAM Brazil

I would just like to add to Gisela's point, from a consumer perspective, what we've been seeing in all of the markets, Brazil and the Hispanic speaking, is that both brands (inaudible) are gradually transferring its strength to the LATAM brand. So we have already seen in most of our organic searches online, but also as a customer recognition, that the LATAM brand has already exceeded our expectations in terms of awareness, strength, and preference in all of the markets where we operate.

Pablo Dabovar - GBN - Analyst

That's very helpful. Thank you.



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Operator

Ricardo Alves, Morgan Stanley.

Ricardo Alves - Morgan Stanley - Analyst

Just two questions. On the international, capacity was up 2% this quarter, and given the -- you guys mentioned it during the initial remarks, the 36% reduction we saw between Brazil and the US, there is still this major shift of capacity on the international operation. So just if you can just update us on that, what is really upsetting the scale back in Brazil? I know that you guys mentioned the South America ex Brazil market going to US and Europe, but just if you could give a little bit more granularity on that.

And then the second one, kind of a follow-up on the domestic Spanish-speaking countries' operations. Just if you could break a little bit more -- break it down a little bit more the unit revenue performance. I don't know, maybe a little bit of color on yield in a few markets, primarily in Chile, Colombia, and Ecuador. And also actually on Argentina, you guys mentioned that's the only one that you are seeing higher unit revenue. So just if you could give a little bit more color on a per country basis and that's it. Thank you.

Ramiro Alfonsin - LATAM Airlines Group - CFO

Yes, on international, yes, we had a very sharp capacity increase last year in the US. We have seen since the last quarter of that year a recovery in that market. We have recuperated some of the flights that we canceled that year, but we still take a cautious look with respect to capacity. Our total capacity in Brazil international will decrease 2% to 3% this year. This is what we expect, and it's basically because of the decreases we made last year.

So the markets in Brazil are recovering not to an incredible extent, but we are seeing strength in those markets, and we are confident that this will continue going forward. But we're going to stay cautious in terms of growth in international in Brazil.

In the case of international Spanish-speaking, yes, that year we grew at a pace that was closer to high single digits. We still expect to see a gradual increase in certain markets, business slowdown with respect to the growth we had last year, and that compounds 0% to 2% capacity guidance that we have for the whole international business.

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

With regards to the Spanish-speaking markets, what we saw in terms of the revenue per ASK breakdown by country is that in local currencies, revenue per ASK are down in all of the markets -- leaving aside Argentina which I will talk about in a minute -- by between 8% and 12%, and since we saw either appreciated or flat currencies in all of these markets, the number is basically similar in US dollars. And that's how we get that 9% or 10% overall number.

When we look at a -- sorry, I would just add to that that in Peru is the only market where the revenue per ASK and where the load factor is also down in most of the markets. This is mostly a yield effect in Peru.

A part of it is yield, but we also have load factors that are somewhat lower, almost 2 points lower than they were last year. They are still at 81%, so they are still healthy, but they are down with respect to what we had in the prior year, reflecting a weaker demand in the market.

In Argentina, the situation is different because we basically saw a 20% decline in revenue per ASK in US dollars, but we also saw 52% in depreciation of the currency. So we actually saw there is revenue per ASK improving in local currencies significantly. The problem is that it is not enough to recover the very high inflation rates that we have in the Argentina market. That was somewhat of a different dynamic in Argentina than the rest of the market.



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Ricardo Alves - *Morgan Stanley - Analyst*

That's very helpful. Thanks, everyone.

Operator

Ravi Jain, HSBC.

Ravi Jain - *HSBC - Analyst*

Hi. Good morning. So I had a couple of quick questions. One is a follow-up on the international markets. We did see some RASK improvement in the fourth quarter. Is that more on the long haul, or is that more on the region and if you could just give us some color there? And the same thing on the competitive dynamics. Are you seeing less competition in either of the two, or is it stable there?

And my second question is on the cost front. As I look into (inaudible) into 2017 and beyond, where do you see the most important opportunities for further acceleration? Of course, headcount is one, but where do we -- where should we expect additional opportunities? Thank you.

Ramiro Alfonsin - *LATAM Airlines Group - CFO*

So, in the case of the RASK improvements, we see better RASK from Brazil roots generally, so both long haul and regional. It is a more geographical improvement than segmented by type of groups. We are seeing slightly less good improvements on the Spanish-speaking side, both regional and local. So what drives today the RASK improvement is basically Brazil.

The second question was --?

Cost of fuel going forward? We're going to keep on this multiyear plan that we have initiated during this year. You probably are going to see more reductions in terms of employees during 2017, in particular on the structure side. We also are going to increase the productivity in airports and utilization of our planes, so you probably are going to see some efficiencies there also. And we also are improving the consumption of airport space, and all the back-office procedures that we were carrying in at the airport level are going to be moved to other areas in order to save on the airport expenses. I guess these will be the main three drivers for 2017.

Ravi Jain - *HSBC - Analyst*

Thank you. That's helpful.

Operator

Renato Salomone, Itau.

Renato Salomone - *Itau - Analyst*

Besides the \$121 million in nonrecurring costs you incurred in the quarter, I understand there were nonrecurring gains on sale and lease backs and subleases. Can you please give us color on the magnitude of these gains and also give us a heads up on what to expect in terms of nonrecurring gains and charges throughout 2017?



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

Yes, in other operating revenues on the income statement, you saw that we had an improvement of approximately \$50 million in other revenues. Most of that, we had \$46 million of that was related to gains on sale and lease back transactions for two wide-body and three narrowbody aircraft.

This is something that we saw also last year -- I mean the year before in 2015, and that may continue to be -- at this point, we can't project it. But it is something that we have seen in the past, and it may continue to be the case for 2017 or coming years as we continue with the fleet movements that we are making.

Renato Salomone - Itau - Analyst

For 2017 four -- are there any charges, fleet related that you have for -- in the radar that you can help us --?

Ramiro Alfonsin - LATAM Airlines Group - CFO

So, as Gisela mentioned, we are redelivering 21 aircraft this year. We have booked that in the different lines of cost. We don't have projections today that we can (inaudible) with respect to that. But it is a sizable amount of aircraft that will be delivered this year.

Renato Salomone - Itau - Analyst

And frontloaded into the first half or you don't -- will these move throughout the year?

Ramiro Alfonsin - LATAM Airlines Group - CFO

They're spread out broadly.

Renato Salomone - Itau - Analyst

Okay. And also if I may have another question. On cargo revenues, you mentioned that there has been an improvement in imports from North America, Europe to Brazil, and there were some impacts from -- in the salmon industry and flowers and asparagus. That seems one-off. Can you give us more color on that, and when will -- we can expect to see cargo yields recovering or turning positive, sorry, year over year?

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

Well, what we are seeing -- the dynamic that we saw in the last months of 2016 and also in the early months of 2017 has been in line with what we're seeing in the passenger business, stronger demand in Brazil. So a big part of the weak cargo revenues has been a very weak import demand in Brazil, which is the higher-yielding cargo demand, and that's something that we are in -- that we are seeing improve slightly in recent months.

On the negative side, we have seen some weaker export markets, mainly related to production issues in the salmon industry and Chile in particular. It is not necessarily one-off. So I wouldn't say it's not something that we won't continue to see going forward. But I do think that the recovery of Brazil will offset the weakness in the export market if we continue to see an improvement in the Brazil situation.

When will yields turn positive in cargo and cargo? Our main issue today has to do with capacity. So, as you know, we are operating 10 freighter aircraft, and that is a significant amount of capacity when you add it to all the belly capacity that is operating in the region, not only from LATAM but also from the international players that are flying to the region.



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So our main focus and I think what's really going to at the end of the day improve our profitability in the cargo business has to do with a rationality on the capacity front, and that's why we continue to remain very focused on trying to reduce our freighter capacity, either by subleasing the aircraft to third parties or re-delivering or returning freighter aircraft.

Renato Salomone - *Itau - Analyst*

Very helpful, Gisela. Thank you.

Operator

Victor Mizusaki, Bradesco BBI.

Victor Mizusaki - *Bradesco BBI - Analyst*

I have two questions here. The first one, can you give some color on your RASK performance in Colombia and Peru with the (inaudible) implementation in the first quarter. And the second question, why don't you take a look on your updated fleet plan? You basically reduced the number of narrow and wide-bodies to be delivered in 2018. So is this a concern about Spanish-speaking countries or just Brazil related?

Ramiro Alfonsin - *LATAM Airlines Group - CFO*

Regarding the RASK in Colombia, Paraguay, I would say the buy onboard initiative is more on the cost savings side where we ended up producing additional revenues per ASK. So basically where we are aiming here is to reduce the cost of the catering we were providing. However, the acceptance of the product was very positive in Colombia, and the initial stage in Peru we were surprised by the acceptance we received by the customers. But it's still very early to say, but we are happy to see that the product is well accepted, and the quality is valued by our customers.

Victor Mizusaki - *Bradesco BBI - Analyst*

And in the case of the fleet reductions, we are taking a quite aggressive approach in terms of increasing utilization. So we believe that we can have a healthy growth for the next three years with the number of aircraft that we have. Plans for 2017 and 2018. We have the capability of moving some capacity within Spanish-speaking and Brazil markets because we operate both airlines to several common routes. So that gives us the flexibility of adjusting to different trends in the market.

So our main goal here is to make sure that the Company has the right amount of CapEx for the needs that we see coming forward, and we also have the lever of having the Qatar planes returning next year, if we believe that the situation in Brazil improves further than what we believe it is today.

Victor Mizusaki - *Bradesco BBI - Analyst*

Okay. Thank you.

Operator

Magdalena Santana, Citi.



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Magdalena Santana - *Citi - Analyst*

I have two questions. The first one is, have you seen any recent adjustment of the amount for USA bound flights in light of some of the political rhetoric coming out of the USA?

And the second one is, what are your (inaudible) on increasing competition from discount carriers like (inaudible)? What should we expect regarding long-term fare trends?

Thank you very much for your answer.

Ramiro Alfonsin - *LATAM Airlines Group - CFO*

On the first question, we don't think the policies that the US is applying have an impact to us. We haven't seen anything on the bookings, and we don't expect that there will be an impact that we can measure on that front at least with the measures that have been made public at this point in time.

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

Regarding the domestic competitor that you mentioned, what we are seeing and are hearing at least is that there is a few of these sort of ultra-low cost carriers that have announced that they will start operating in some countries in South America in the coming months or years. And Peru specifically is the most imminent, I would say. In Chile, as you mentioned, JetSMART has planned to start operations towards the end of this year.

These carriers, from at least from what we are able to see, are obviously low-fare operators. So we do expect them to come in at lower price points. But this is something that is to be expected and that is a global industry trend. We have, as you know, started working on this new domestic business model. Already, we announced it last quarter, but it is work that we have already been doing for over a year that basically seeks to incorporate or to change the way that we operate for our short-haul and domestic flight in order to be able to offer a very competitive cost structure that will allow us to match the very low fares that will be offered -- the very low base fares.

But our business model is very different from these players because we also cater to the corporate passengers, and we have elements in our business model like the strength of our network, like our frequent flyer program, like the connectivity that we are able to provide either directly or through our agreements with partner airlines that differentiate us from the ultra-low cost players.

So we do expect to be able to compete with them on fares, but we are also targeting a type of passenger that they are unable to target with the business model that they have.

Magdalena Santana - *Citi - Analyst*

Okay. Thank you, Gisela. And I have a follow-up question. You already gave us more color about the ancillary revenues that we saw in this quarter. What sort of trend do we expect going forward?

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

We expect growth. Definitely we see an opportunity for growth there in line with what we've seen in the industry in general. We are -- today I think it's -- easily I think in the longer term we can more than double the ancillary revenues that we have today. Currently we are at less than \$3 per passenger, and the industry benchmarks are \$8, \$12, in some cases even \$20 per passenger. So we definitely see an important opportunity for growth on that front.



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Magdalena Santana - *Citi - Analyst*

Okay. Thank you. And my last one. Sorry. What sort of annual aircraft CapEx should we expect regarding a normalized long-term growth rate?

Ramiro Alfonsin - *LATAM Airlines Group - CFO*

We've been focused in making sure that we reached our target for 2017 and 2018. I think that we're still comfortable with the levels we reached, and we got over that \$2 billion mark that we posted earlier in the year that it was our goal. We will continue to update you on a quarterly basis with respect to our plans going forward. At this point in time, we are focused on making sure that for the next 24 months, we have the right size of fleet.

Magdalena Santana - *Citi - Analyst*

Well, thank you very much, Ramiro and Gisela. I really appreciate it.

Operator

Rene Pavez, Santander.

Rene Pavez - *Santander - Analyst*

Okay. Thanks for taking my questions. The consolidated revenue per ASK ex cargo in USD terms increased almost 8% for the first time in 10 or 11 quarters, closing the year down 6.5% and after a drop of 20% two years ago. So which is the consolidating assumption of revenue per ASK behind the guidance in our (inaudible) terms for this year?

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

Our guidance is -- sorry. Sorry. Just a minute. We have a problem on the line.

Rene Pavez - *Santander - Analyst*

Okay. Okay. We have -- our guidance are the guidance that we provided on a margin basis, so this -- we are not at this point able to tell you what we expect the revenue per ASK to be during the year. It varies in different markets related to the macro situation and to the competitive environment. I think that we have seen the consolidation of a positive trend, but our guidance is only based on ASK growth and margins. So we can't really tell you a number for revenue per ASK.

Rene Pavez - *Santander - Analyst*

Excellent. Thanks.

Operator

Thank you. And I'm showing no further questions from our phone lines. Thank you, again, for joining us today. Please feel free to contact the Investor Relations department if you have any additional questions. We look forward to speaking with you again soon. Have a great day.



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Thank you, everyone.

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

Thank you.

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