



Operator:

Good morning, ladies and gentleman, and thank you for holding. Welcome to the Smiles conference call to discuss the earnings results to the 3Q18.

Soon after the Company's presentation, we will go on to the question and answer session. You can enter the queue to pose a question by pressing *1. Should any participant require assistance during the conference, please request the help of an operator by pressing *0.

Please be advised that some of the information contained in this conference call may contain statements or projections on forward-looking expectations. Such information is subject to known and unknown risks and uncertainties that may lead such expectations not to materialize, or to be substantially different from expected.

Today, we have with us Mr. Leonel Andrade, CEO; and Mr. Marcos Pinheiro, CFO. We will now give the floor to Mr. Andrade. You may proceed, sir.

Leonel Andrade:

Thank you very much. Good morning to all of you. It is a pleasure to be with you to present the Smiles' results for the 3Q18. I would like to invite you to follow with me the financial and operational highlights.

We had a very strong quarter; quite satisfactory when it comes to the Company's operating indicators, beginning with our billings. I tend to underscore billings, I always have, because our billings point to the Company's future. We had a strong growth of 17% in accordance with the previous quarter, but with a completely different level in record billings for the Company, reaching R\$588 million.

In terms of accrued miles, we have a historical record reaching 27 billion miles, showing that Smiles is clearly a market leader, with a strong engagement with its clients. We have a 19% growth vis-à-vis the previous year in accrued miles, and a growth of 33%.

Perhaps, the strongest point in the quarter was the redemption as it brought about substantial growth in the Company revenues, changing the level. EBITDA was R\$231 million, almost a 42% growth vis-à-vis 2017. This EBITDA has the component of a one-time transaction that will be explained by Marcos.

Anyway, the Company's operational growth was consistent. Financial results reached R\$96 million, also with a growth vis-à-vis 2017. Our net income is R\$212 million; it had a slight drop due to extraordinary events.

In the 3Q17, we had a reorganization because of Webjet. We now have something like R\$59 million of extraordinary results. When we compared these results without extraordinary expenses, we would still have a growth of 5% vis-à-vis last year.

On the following page, I would like highlight a change in structure we have undertaken, and this necessary when we think about ability to compete in process.



In September, Smiles carried out the migration of the Oracle system to the cloud. I highlight this because we were the first Company in the world to adopt Oracle Cloud infrastructure for the loyalty system, with the Siebel Loyalty, and we are the first company to operate with this system in the cloud.

This means that we will continue to maintain our infrastructure both in Amazon and Oracle. And, for this, we have been acknowledged as a global case study as the best loyalty program.

Why am I highlighting this? Because this is and will continue to be fundamental to develop business projects at the Company. This is first quarter where we have no great innovation projects, exactly because of this change in infrastructure.

Our innovation pipeline continues to grow strongly, and we will create products and partnership in a consistent way. This quarter we have the entry of four **airline** companies that have already been announced.

With this, now I would like to go to the main operational highlights, turn the floor over to Marcos and, of course, I am here at your disposal for questions. Thank you for your attention.

Marcos Pinheiro:

Thank you, Leonel. Good morning to all of you. We continue with the presentation on slide number three, showing you the accrued miles volume. This was an exceptional growth quarter, showing the commitment we have with the expansion of the loyalty business.

In the quarter, we totaled 27 billion miles accrued, a growth of 18.8% vis-à-vis 2017. As Leonel mentioned, we continue in the same pace of expansion of our business. We go on to slide number four, and we would like to refer to the great highlight of this quarter, which refers to the miles redeemed.

This reflects our commitment with the engagement of our clients. It shows our outlook to consolidate our leadership in the loyalty segment, with a focus on travelers. This result of almost 23 billion miles redeemed in the quarter shows a growth of almost 34% vis-à-vis 2017. And this is the most solid message we can send to our shareholders and clients, whom are our main concern.

We continue on slide number five, once again, showing you the performance referring to the total gross billings for the Company. Billings totaled R\$588 million this 3Q, with an expansion of 18% vis-à-vis the same period in 2017.

And the most important message is the constant evolution, an evolution of 7% vis-à-vis the 2Q18. Sequential increases in billings allow us to work based on this. And we insist on maintaining this trajectory.

On slide number six, I would like to highlight the breakage rate. The rate had a slight drop this semester, but is still very stable of around 18%, once again reflecting a breakage revenue of about R\$60 million.



We consolidated, on slide number seven, the Company's net revenue for the last twelve months. In a sequence, we are able to once again show you this successful trajectory for the Company. My deep and sincere thanks to our clients and all of our associates that have built this. Once again, we are able to show this constant evolution in the Company.

In this quarter, we totaled revenues for the last twelve months accrued at R\$943 million, once again, a historical record.

On slide number eight, "the gem of the crown"; what to do to maintain the Company attractive for users and our profitability. The focus is on the Company's operational performance when we think in its profitability.

In the 3Q18, we reached a level of profitability and a direct redemption margin of 42.5%, a slight enhancement vis-à-vis the previous quarter, and something very similar to what we obtained in the same period in 2017.

We go on to slide nine to highlight the EBITDA for the Company. As Leonel mentioned, in the 3Q, we had the extraordinary effect bringing an one-time effect of R\$38 million for the Company's results. Notwithstanding, this result was R\$193 million, once again reflecting which path the Company is on.

We go on to slide number ten where we show the Company's net income evolution. It is interesting to observe that the 3Q17 and 3Q18 were impacted by extraordinary events. When we exclude the impact of these events, we are able to observe that the recurring net income figure has an evolution of approximately 5%.

We go on to slide number eleven, where I would like to shed some light for our audience in order to explain what generated this extraordinary effect in the 3Q18. To sum this operation, I would like to say that the estimated breakage we work within the Company does not correspond to revenues for taxation purposes.

Now, based on this interpretation, we observe that there was an amount that could be recovered from taxes. We were conservatives, as we have been in the last six years. And this is reflected in the net revenue results – R\$59 million.

If you look at the Company's balance sheet, the total effect of this operation amounted to R\$260 million. With this slide, I would like to end this part of the presentation, and we will now go on to the question and answer session. Thank you.

Alexandre Spada, Itaú BBA:

Good morning to all of you. I do have two points to discuss. Thank you, Marcos, for the non-recurring effects. I would like to check if I have fully understood this. There was a non-cash effect of R\$90 million in this quarter, implying a payment of income tax based on a 34% aliquot.

Nevertheless, the fiscal credit generated by this difference, because of the difference in breakage revenue, will generate approximately R\$260 million. In practical terms, these adjustments implied to the Company up to R\$230 million, which should be generated throughout the coming quarters. So, does this explanation make sense?

Marcos Pinheiro:

Spada, good morning. Thank you for your question. Yes, that does make sense. Thus, a positive impact on results of approximately R\$92 million net of taxes because this generates taxes to be paid (audio glitch - 13:05) benefits, having a greater cash balance for coming periods, an increase in revenue for the Company. So, yes, your comment does make sense.

Alexandre Spada, Itaú BBA:

Is this amount about R\$260 million?

Marcos Pinheiro:

Yes.

Alexandre Spada, Itaú BBA:

Thank you very much, very clear. Allow me to go on to my second remark. I would like to pose questions regarding the possible capital closing process of Smiles. I understand that the first step would be a creation of an independent committee that will be responsible for assessing assets, hiring third-parties to do this and, then, to negotiate the swap ratios between Smiles and Gol.

Having said this, I would like to know if the committee has already been defined. How many participants will the committee have? And if the Board members can participate in this committee or not.

Leonel Andrade:

Spada, thank you for your question. Before beginning, I would like to underscore that all this transaction has been carried out in a very transparent fashion, fully compliant with legal issues, and with financial and legal consultancy in order to be able to proceed in a highly transparent way and to obtain the best equity possible.

The responsibility for nominating the committee pertains to the Board of Management. Our Board of Management has set up an Extraordinary Assembly for November 29, if I not mistaken. And the Board will indicate and nominate this Independent Committee. We still do not have a clear definition; discussions are still underway, involving the Board members, as they are conducting this process.

It is possible that we will have three independent members that will be nominated by the Board of Management. We are undoubtedly speaking about highly trustworthy people.

Once again, what we would like to do is to be fully transparent to provide all of the information requested. And our outside support will be nominated by our committee, whether legal or financial, for financial assessment or otherwise. This committee will have the sovereignty to nominate and contract any support it may require.

Alexandre Spada, Itaú BBA:

Thank you, Leonel. I still have a doubt. Let us presume that there will be three people in the Committee. How will they be selected? Is there any clarity regarding this? Does the Board have to reach unanimity, so that each of these independent members can be nominated, or not? Could we have a member elected by controllers and the rest by minority shareholders, or two chosen by controllers and one by minority shareholders? Are there any details regarding this?

Marcos Pinheiro:

Spada, let me attempt to be very clear. The Board of Management will be fully responsible for defining this in the coming days, and everything that will surround this transaction.

What I can add is that it is the interest of our Board and the interest of our shareholders is to deal with this in a highly transparent way, complying 100% with the CVM guidelines.

Once again, it is the Board that will choose how and which will be the composition of this Independent Committee. As soon as this has been deliberated by the Board, we will be sharing all of this additional information with you.

Leonel Andrade:

It is important to highlight that this Committee will be named with highly expressive people with broad experience in the Company's reorganization. Once again, we have no doubts about this.

Alexandre Spada, Itaú BBA:

That is excellent. This is what we all hope. Thank you for the clarity in your responses.

Felipe Vinagre, Credit Suisse:

Good morning. Thank you for taking my question. The first question refers to this extraordinary effect and the accounting for this. There was a recognition of a provision of R\$259 million. In accounting terms, I would like to understand how this R\$259 million amount was recognized. Was it recognized in a single time? Has a cash effect come subsequently? Why has not this already been included in the results, all of the potential gains that you have from this? In my interpretation, it seems that you still need to recognize these potential gains throughout this quarter. I will then go on to another question.

Marcos Pinheiro:

To give you further clarity, perhaps you will understand the additional steps of this operation looking at our explanations on the ITR, the statements of account.

What generated this benefit in the past was the fact that we had paid conservatively because, until the normative instruction was published, we paid a higher amount of

taxes compared to what was due, based on our perspective nowadays. And these taxes were paid in a conservative fashion because our understanding was that we should offer to fiscal purposes everything that we obtained from the breakage rate.

This moment I am referring to is December of 2017. The revenue estimate is not definitive, and it cannot generate an accounting or fiscal impact on the Company.

What was done, therefore? We opened our books and, once again, measured the Company's results looking at them from the perspective that this provision should not have generated income tax, PIS/COFINS that have been paid previously. What happens is that this is a temporary difference, it does not represent a permanent gain for the Company. It is simply a shift of this transaction through time.

Our accounting actions are simple. We have income taxes recovered, R\$260 million; we also have differed taxes and fiscal impacts.

Now, what is included in the results? For the Company results, we have the effect in the present day exercise, which is small, and a monetary correction because of the additional that we paid for taxes.

If you wish, I can send you more details. We are setting up a highly illustrative table, but this is what happened. We paid more taxes on the past; not mistakenly, but in an anticipated fashion. And this is what is being corrected now. When we do the proper accounting, the net effect is R\$59 million in current accounts.

Felipe Vinagre, Credit Suisse:

This will lead to my second question. Looking forward, therefore, we should see this extraordinary profit during some time. What will happen going forward, and until when will we see this?

Marcos Pinheiro:

These taxes that we will recover will become a rate. In fact, they will become something real, something that we have to pay in the Company in terms of income tax, PIS/COFINS and social contribution, so on and so forth.

Therefore, the benefit of this contribution, as I explained in the previous question, will carryover a cash balance that is marginally higher during a certain period. And this marginally cash balance will create gains of revenues for the Company.

Felipe Vinagre, Credit Suisse:

Thank you very much. My last question, speaking about the Company outlook, this 3Q seems to be very strong, and the economic situation of the Company is extremely good. Through the message of the Company controller, there was a mixed message, a problem with competition, and I would like to understand which is the outlook from you to reinforce that we have received the right message. Which is the Company outlook, and the perspective for growth and competition.

Leonel Andrade:

Felipe, thank you very much for the question. I think we need to separate things. There is no controversy here. When it comes to the Company's results, they continue to be very strong. All the (audio glitch - 24:07), and, as you can see, we have had a constant evolution by looking at all that graphics.

There are no outliers. The focus has always been gross billings with a margin. Billings continue to grow at a faster pace, perhaps faster than what was expected, because we are working better with the banks and with the products.

As I have always advocated, billings dropping means the disappearance of the Company in the long term. We cannot have it here. We cannot have the controller, or a shareholder, or you, the analyst or investor, looking at the business and thinking that the business is deteriorating or worsening.

That is why we are making a decision. The business has performed in a consistent way through time, and this is our outlook for the short term.

I would like to remind you that, for five years or more, people have been asking when the margins would drop. They have not dropped. I cannot give you any guarantees, but I do not foresee any risks in the three or four coming quarters.

I do believe the Company will continue to have a consistent performance. It is very well structured for this in marketing, products, technology, operations and trade agreements. By looking at the Company, we do have the possibility of having a strong performance.

Now, clearly, there is a change in the competitive environment. We are a business that focuses on travel. We always have been and will continue to be. Because of this change or incorporation, I see no change in the Company's focus.

But, clearly, there is a change when we look at the viewpoint of the airline controller. There will be a change in scenarios, without any doubt, and there is no controversy in this.

My response is the business is consistent, strong, it has performed and has everything to continue performing. I am, of course, at your disposal to clarify any points. There is no risk in the short term and the long term.

There may be some competition risks that will lead us to making changes. We have proceeded in a highly transparent way. Our governance is intact and we will continue working for the clients and for our partners, without any further changes.

And I believe that the 4Q will continue to be very strong. The month of October has maintained its performance – it ends today – and I believe the 4Q will be another highly satisfactory quarter in terms of results.

Felipe Vinagre, Credit Suisse:

Thank you very much, Leonel. A very clear response.

Samuel Alves, BTG:

Good morning. Congratulations for the results. My question refers to a deliberation of the Board of Management. I am reading in the minutes that you approved unanimously a plan for executives that would come into effect until the date of the Extraordinary Assembly that will be held on November 29. I would like to ask you to shed more light on this. Which is this plan for the retention of executives? Could you, perhaps, give us more color in terms of this Board approval?

Leonel Andrade:

Thank you for your question. Not all details can be disseminated, perhaps for several reasons, but it is not for this assembly on the 29. This assembly that will be held in 30 days is an Extraordinary Assembly for works to begin on a possible restructuring.

What was approved by the Board of Management is aimed to motivating the main executives of the Company to continue working with focus on the Company until we have a future definition of this transaction.

This transaction has been fully transparent. It will be defined in the assemblies, with the support of an Independent Committee, all aligned with the CVM opinions.

What we are going to do is to continue having the focus on the operations with partners and clients throughout the entire period. A period that could extend for some months, according to our expectations. We are going to give full support to the committees, full support to all shareholders, and keep our focus on the operations.

This is the goal, to have the commitment and incentive of remaining in the Company, and this is the incentive of the controller, so that our business can continue to perform and, preferably, surprise the market.

It makes no difference if in the future the Company will be incorporated, which will be the model we will work with, or if it will continue as it is at present. All of this will have to be mapped.

As the Company's CEO, my obligation is to ensure that the Company performs at the best. At the end of the day, there will not be any fights, none of the executives are intending to leave the Company in the coming months, abandoning the Company because of the restructuring. My commitment with the controller and shareholders is to ensure that the Company continues to perform.

When it comes to details, they cannot be disseminated publicly, but we will be transparent, and we have to think of new incentives to carry out this work. I hope my response was clear.

Samuel Alves, BTG:

Yes. I think your message was very clear, Leonel. Thank you.

Alexandre Spada, Itaú BBA:

Thank you for taking another of my questions. I simply wanted to clarify some points regarding the strategic planning for the coming five years. As I understood, you are attempting to double the generation of results of the Company between 2017 and 2022. Is the starting point this recurrent result of 2017, or the gap results that consider this extraordinary gain? This is my first point.

Leonel Andrade:

Spada, thank you for your question. The starting point has always been our operating results. Extraordinary or not, or extraordinary variations due to the exchange rate have always been part of our plan. And the breakage work has been done despite the great oscillation, with the greatest amount of foreseeability.

We speak about accruals, redemption, revenues, maintaining margins, and when we speak about growth, we refer back to this operating results. And the extraordinary gains from Webjet are, of course, not part of this plan.

Alexandre Spada, Itaú BBA:

So, in terms of operational results, what we can understand is that there will be adjustment to recurrent net revenues.

Leonel Andrade:

The truth is that I do not fully understand your question. Forgive me for being so frank. When I speak about operational results, we do have the possibility to forecast financial results, but they could undergo strong changes due to the Selic or any other variation, and our day-to-day focus, and this is one of the great merits of Smiles, is to always present consistent operational results, ensuring that the breakage will never become an obstacle to our results.

Alexandre Spada, Itaú BBA:

When I hear of operational result, I think of EBIT and, based on previous interaction with you, I have been feeling that the idea was to double net income, not the EBIT.

Leonel Andrade:

Let me be clearer: our strategic plan foresees a growth in strategic indicators of 15% p.a. This does include net revenues and net income. The strategic plan does not include extraordinary results that could impact net revenues, as, for example, the Webjet event.

Alexandre Spada, Itaú BBA:

Thank you, Leonel. This is very clear. And when we think of recurrent net revenues, in 9M17, you delivered approximately R\$450 million. In the 9M18, this amount is R\$420 million. This year, therefore, the Company will not be delivering the 15%. I just would like to understand if you still you think there is a reasonable chance of, until 2022, complying with that the strategic planning. This would imply a growth greater than 15% p.a. for the coming years.

Leonel Andrade:

Your question makes sense. When we look at the strategic plan, it foresees several new initiatives that will speed our result, for example, international expansion, or everything relating to the Traveler's Universe, that is still at the beginning. This is very clear.

Now, there is the fact that this year we will not have a growth of 15% in net income. Although margins and others are growing beyond 15%, and I do not foresee a change in this plan. And our strategic plan depends on revision.

Today, we are focused on the same plan and the same growth rate, and all the measures are geared to complying with that drastic changes in the competitive scenario, especially in the airline business that could lead to a change in this plan and our performance. But this is annually reviewed, and, at this point in time, there is no change in the strategic plan. The fact that our revenues are somewhat below will not change anything.

The 1H was less consistent than it is at present, and this difference of the 1H18 has, of course, already ended. But we have great expectations until the end of the year. There is no change in our strategic plan for the Company and it will mature differently, based on new initiatives that are coming in place.

Alexandre Spada, Itaú BBA:

If you allow me one last remark, very shortly, you should announce the change of price with Gol that will come into effect for 2019. If you could remark on the expectations that you have, how will this revision go?

Leonel Andrade:

I would like to underscore that is a current revision, as we have had every year, with the same governance, with internal approval and independent committee. There will be no change in contract nor in policies. And this is important to underscore.

It is too early to say, but I think we will have a growth in this payment because what makes up this price is a key factor –the aviation kerosene–, which has had several increases, with a strong impact on marginal costs. But it should be positive and it should increase the price of Smiles.

Alexandre Spada, Itaú BBA:

Thank you very much, Leonel. It was a very clear response.

Matt Sallson, Deutsche Bank:

Hi, guys. Could the competitors' pressure appear to Gol's management as the reason for to the proper reorganization, or also (38:54) by a competitor, who has been (38:65) their loyalty program? How can both programs be losing share?

Leonel Andrade:

Thank you for your question. I believe that the controller's decision to propose a restructuring is based on the market situation of the airlines, risks and opportunities and a very transparent market vision. And, if we observe global movements, even in Brazil, loyalty programs, in general, are going back into the shelter of the airlines.

There are opportunities and risks that have been mapped out, but from the governance viewpoint, or from the legal viewpoint, this process is highly transparent and, within the Company, we are going to ensure that this process will advance with full support to shareholders. Our obligation is to care for the Company in the best way possible.

Now, clearly, we are not under any pressure. It is fundamental to state this. Absolutely no pressure from the controller, or from the airline management. Our governance has always been fully respected. Paulo Kakinoff and other statutory members have always respected the Smiles' decisions, and you can rest assured that this will continue on.

As long as the Company is independent and under our management, this will not exist and should not exist. It will not exist because the controller has always been extremely correct and very respectful in terms of governance. This does not exist, quite the contrary, and I can assure you that this is not in vain, that we have a very strong performance, and everything we do will be submitted to the Smiles' Board of Management.

I hope I have answered your question and I am at your disposal for further clarification.

Matt Sallson, Deutsche Bank:

Thank you. And just as a follow-up, can you give us an idea of the timeline the independent special committee is operating under, or is it to negotiate the terms of the reorganization? Thanks for taking our questions.

Leonel Andrade:

Thank you. Simply to answer this, in your initial question, you asked why programs are losing market share, but I am not sure if you were referring to us and our direct competitors, or to another competitor. We have never lost any market share in the Company's six years of existence; quite the contrary, we have consistently increased our market share until we became leaders in all the main indicators and, with the result that we have presented today for the 3Q, and we will have great gains in market share.

This result arises from several miles and businesses with banks, and bank clients decide what to do with us or with competitors. As we have had gains this quarter, we think we will have further market share gains. There should be no reduction in our market share. If we look at the Company as it is at present and at its Management, we are extremely proud to say that we have consistently complied with all the indicators.

We are part of an association, ABEMF, which had a growth of 9% increase in billings during the 1H. Our growth was 18%, a double of that. When we look at the ABECS association, at which I serve as a Director, credit cards have had a growth of 14%, while our billings reached 18% in loyalty this year. And Smiles' share has grown in credit cards. We would like to highlight that we are not losing market share; quite the contrary, I do not deem this to be a risk.

And now I will ask for Marcos' help to respond to your second question, the schedule for the special independent committee.

Marcos Pinheiro:

Thank you for the question. When it comes to the schedule, the primary steps are the following: today, we published the convening letter for shareholders that will alter the social status of the Company, allowing the incorporation proposed by Gol to continue on this aligned with CVM's good governance practices. Notwithstanding, the Smiles' Board of Management has already been working in order to think about how to set up this independent committee.

There is nothing mandatory stating that the Company or its Board would have to define the names of the members beforehand, but what I can share with you and all the community of shareholders is that the Company and its Board of Management is fully interested and working in a highly transparent way and conducting this process in an exemplary way.

When our Board members come to an agreement on which will be the name that will add to the analysis of this transaction, this will be immediately communicated to the market. Speaking more objectively, we still do not have a date we are working with for the election of this independent committee. But, of course, we are interested in speeding up this process. I hope we have responded to your question.

Matt Sallson, Deutsche Bank:

Yes, you have answered my questions. Thanks.

Operator:

The question and answer session ends here. We would like to return the floor to Mr. Leonel Andrade for his closing remarks.

Leonel Andrade:

We would like to thank all of you, and I would like to close by highlighting the following: the first and fundamental point is that we do have a vision that the loyalty programs have undergone an enormous change and a similar movement are happening in the market. We have had the case of LATAM, Air Canada and Aeroméxico. Now, it is interesting for the Controller to discuss this movement.

What I would like to highlight is that all of this has been done transparently. The market agents and others have been, along with the market, exclusively informed. Therefore, Gol has been highly transparent and, of course, extremely diligent, clearly following through in this process.

At Smiles, we will continue to ensure that this will remain this way, offering the necessary support for the independent committee and to the Board of Management, so that the decisions made will be clear, have all of the information necessary, and be transparent and balanced, once again. We will continue working towards it. This is the



commitment we made to all of you and to the market, and especially to our employees and clients.

We are 119 employees; this growing, historical result is the result of an exceptionally good team that is highly committed. We are going to continue to operate the Company with full transparency and with the focus on clients and partners and we will continue to gain market, God willing it, and generating a great deal of value for all shareholders, with consistently high margins and with a sustainable growth of our operations. This is our commitment.

You can be fully convinced that this is what we are going to do in the coming months or in the future. I assure you that this transaction will be highly supported to our commitment. Once again, thank you all. This is the last call for this year, and I trust that we will end the year with very good results and I wish you a very fruitful end of the year. Thank you very much.

Operator:

The Smiles conference call ends here. We would like to thank all of you for your participation. Have a good day.

Conference Call Transcript
3Q18 Results
Smiles (SMLE3 BZ)
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