

THOMSON REUTERS STREETEVENETS

EDITED TRANSCRIPT

LAN.SN - Q1 2015 Latam Airlines Group SA Earnings Call

EVENT DATE/TIME: MAY 15, 2015 / 2:00PM GMT



CORPORATE PARTICIPANTS

Gisela Escobar *LATAM Airlines Group - IR*

Claudia Sender *LATAM Airlines Group - President, TAM*

Nicolas Goldstein *LATAM Airlines Group - CEO, Long Haul Business*

CONFERENCE CALL PARTICIPANTS

Savi Syth *Raymond James & Associates - Analyst*

Duane Pfennigwerth *Evercore ISI - Analyst*

Bernardo Velez *GBM - Analyst*

Michael Linenberg *Deutsche Bank - Analyst*

Daniel Guardiola *LarrainVial - Analyst*

Stephen Trent *Citigroup - Analyst*

Joe Mora *BofA Merrill Lynch - Analyst*

Rein Paviv *Santander Asset Management - Analyst*

Ari Friedman *Cobalt Capital Management - Analyst*

Carlos Luro *JPMorgan - Analyst*

PRESENTATION

Operator

Good day, everyone, and welcome to the 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 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 (technical difficulty) international markets; therefore, they are subject to change.

Now it is my pleasure to turn the call over to Gisela Escobar.

Gisela Escobar - *LATAM Airlines Group - IR*

Great. Thank you very much and good morning, everyone. Thanks for joining the call.

I wanted to introduce here the people that are on the call with me: Andres Osorio, who as you know is the Chief Financial Officer of LATAM, as well as Claudia Sender, who is the CEO of TAM in Brazil; and Nicolas Goldstein, who is in charge of the international passenger operations.

If you turn to the slide presentation that we have on the webcast, we are going to go over the numbers that we published last night for the first-quarter 2015 financial results. Before we go straight into the numbers, I just wanted to mention a few brief introductory remarks.



As you are all aware, during the first quarter and really the first few months of this year, we have been seeing a fairly challenging macroeconomic environment in South America. We have seen important devaluations in all of the local currencies in the region: the Brazilian real, the Colombian peso, the Chilean and Argentine peso, as well as the Peruvian currency. So all of these have had an impact on our unit revenue numbers, especially for our domestic operations, as well as more demand on international routes.

And on the other hand, we have also been seeing, as has already been the trend for the past quarter, a decline in corporate demand in the Brazilian market as a result of the macro environment in Brazil. And also the macro environment in general in that country has been affecting demand for international travel as well as for the cargo business.

So considering that environment, we are very happy with our first-quarter numbers. We think that we were able to successfully manage this difficult and complex environment. We had obviously certain external positive impacts, like the 40% decline in the price of fuel, with fuel at \$2.09 per gallon in the first quarter. That was a significant decline versus what we had in first quarter 2015 and generated, as you saw in our P&L, savings of approximately \$300 million.

In addition to that we are also positively impacted on the cost side by the devaluation of the local currencies for the portion of our costs that are denominated in those currencies, which are approximately 40%. So that gives us also a competitive advantage, especially when we compare ourselves to our international competitors. Costs are, for the most part, US dollar-denominated.

And then, finally, we're seeing the positive effects of our cost control initiatives, which we have already been discussing with you for the past couple of quarters, whereas you know we have in place a cost control program that looks to reduce our cost per AFK on an ongoing basis over the next three years.

In addition to that, during the first quarter we have continued to make progress on a series of other initiatives that has to do with improving our customer experience and also that we continue to progress in terms of our network initiatives, where we are consolidating our hub strategy within the region and leveraging our networks to provide the best connectivity within, to, and from South America. And we also continue to make progress with our fleet renewal that results in improved efficiency in terms of our cost per ASK on the fleet side, as well as an improved passenger experience as we incorporate these new and modern aircraft into our fleet.

So with all of this, we feel that the first-quarter numbers were good, solid numbers and that we feel we are in a good position going forward to offset some of these negative effects that we are seeing in the macro environment.

If we look at our first-quarter numbers overall, you can see that we had a decline in terms of revenues of approximately 12% and that was more than offset by our reduction on the cost side. So overall our operating costs were down 16%. And that resulted in an improvement in terms of our operating margin, which reached 8.1% during the first quarter, which is more than double the 3.5% that we had in the first quarter of 2014.

In terms of our EBITDA margin, this was 21.3% in the quarter, significantly higher than the 15% that we showed in the first quarter of 2014.

When -- if you look at slide number 3 in the presentation, you can see that on the net income side we presented a net loss during the quarter. This was mainly due to the fact that we had the non-cash foreign exchange rate effect as a result mainly of the devaluation of the real. We closed December 2014 with an exchange rate of BRL2.66 for the real and we closed March with an exchange rate of BRL 3.21 for the real. So the mark-to-market of TAM's balance sheet, especially to this exchange rate, results in a non-cash loss that amounted to approximately \$200 million during the first quarter.

If you turn to slide number 4, looking here at the revenue performance in our different passenger businesses, you can see that as a whole we had a slight increase in our ASKs. We have been, as you know, during the past couple of years reducing overall our capacity and during the first quarter we have -- we are seeing some growth, especially in our international passenger business, where ASKs were up 2.4%. And on the domestic Spanish-speaking operations, where our ASKs were up 4%.



As a result, total capacity for our operations were up 2% in the quarter. Traffic was up somewhat more than that and that resulted in very strong load factors of 83.4% overall in the quarter, which is almost 1 point higher than in the first quarter of 2014. Load factors were up in all of our passenger operations.

When we look at the revenue per ASK number on international passenger routes, revenues per ASK were down 8%. This is mainly a result of yield pressure and that is sort of a continuation of what we were already seeing in the fourth quarter of last year.

We are seeing a decline in terms of the -- or let's say weaker passenger demand for international routes, especially out of Brazil, as a result of the volatility in the Brazilian exchange rate. And we are compensating some of that with changing our point-of-sale mix in the region and moving sales to other countries -- international sales efforts to other countries in South America where demand continues to be strong. And with that we have been able to offset some of the decline.

On the domestic Brazil operations, our revenue per ASK in US dollar terms was down 19.6%. If we look at this number in Brazilian reals, the revenue per ASK was down approximately 5% so a large part of this decline has to do with the devaluation of the Brazilian currency. And the 5% decline in local currency has more to do with the weaker corporate demand that we have already been seeing in the past few quarters.

When we look at the domestic Spanish-speaking countries, we have a 4.1% reduction in revenue per ASK. This is a very good number when you consider the devaluation that we have been seeing in local currencies. In Chile and in Argentina the local currency devalued by approximately 13%, 14% and in Colombia by approximately over 20%.

So when we look at the numbers in US dollars it includes that depreciation, meaning that the yields in local currencies were actually up during the quarter despite the lower price of fuel. This has resulted in strong margins for these businesses during the first quarter of this year.

If you turn to slide number 5 to talk a little bit about the cost side, what we have been seeing here in general is a decline in really practically all of our cost lines. If we look at our costs excluding fuel, we have on the wages and benefits side a 4% decline. Part of this has to do with the devaluation of local currencies, since a part of our wages and benefits, a significant part is denominated in those currencies.

And if you look at our other cost line, basically we have a 5% reduction in terms of aircraft costs, which includes depreciation. It includes aircraft rental costs and maintenance expenses as well, and a 13% decline in all the other cost lines. So ex fuel, that puts our cost per ASK approximately 10% lower than what we had during the first quarter of 2014. If we add to that the 30% reduction in fuel prices, our cost per ASK overall was down 17%.

Now there's a couple of things that we wanted to highlight in terms of our ongoing initiatives for the year. When you look at our network, what we are showing here on slide number 6 are some of the new routes or additional frequencies that we are adding during 2015.

Our growth for this year is very much focused on strengthening our hubs and on better feeding the hubs that we have defined in the regions, which are, as you can see on the map, basically Sao Paulo Guarulhos, a strong hub in Brasilia, especially now for the domestic operations in Brazil; a strong hub in Lima for a connectivity within the region and for long-haul routes; on the west coast of South America.

And also, as we announced during the quarter, we are doing right now the feasibility analysis for the development of another hub in the Northeast region of Brazil. That hub basically explores the very efficient way to better connect that region of Brazil, especially with Europe, which we can serve very efficiently from that geographic location.

If you turn to slide number 7, we've also made progress on the customer experience aspect. We have during the first quarter launched the new VIP lounge in Santiago, so certain initiatives to improve the passengers' experience before the flight. This is the largest lounge in South America and it's significantly improved versus what we had in Santiago previously.

We have also started to test single check-in counters in certain airports. For now we have them in Miami, Madrid, and at Sao Paulo airport, where you can have a single check-in counter to check in both LAN and TAM flights.



On the flight, in terms of once you are on the aircraft, we are advancing in terms of improving the in-flight entertainment options. Specifically, we are in a project to install wireless in-flight entertainment where passengers can access LATAM's entertainment system through their own devices with access -- this is especially important for narrowbody aircraft where we don't have single screens for all the passengers. We have that so far in 10 of our narrowbody planes and that should be finalized during the course of this year on all of our narrowbody fleet.

And, finally, we are -- continue to invest in terms of digital solutions for all our passengers so that they can have better connectivity to manage their own flight status and to be better informed, especially in the event of [cancellations].

Another aspect that is very important from the perspective of our passenger experience has to do with the on-time performance. We continue to have very high levels of punctuality throughout our networks. We have had significant improvements during the first quarter compared to last year.

The first quarter of 2015 in Brazil our on-time performance with a 15-minute standard reached 84.4% and on international routes 82.5%, both significantly higher than in the first quarter of last year. And in the Spanish-speaking routes we saw a slight decline.

It still has the highest on-time performance of all of our operations, but, at 86.1%, it's somewhat lower than what we saw in the first quarter last year. That has a very specific explanation that has to do with the volcano eruption that we had and with specific weather issues during the month of March that affected the punctuality in the domestic Chile operations. So if you look just at the domestic Chile numbers, that was down from around 92% in 2014 to almost 88% in 2015.

Moving on to the next slide, another important aspect that we continue to be focused on and that we have continued to make progress on is the continued renewal of our fleet. Even though our ASKs are up only 2%, we have taken delivery of newer aircraft and are phasing out of our fleet the older families of aircraft.

If you look at our short-haul fleet this quarter compared to the first quarter of last year, there's two types of aircraft that we have completely phased out, basically Dash Q400s and the 737 fleet that we used to have in Colombia. We are reducing also a little bit the number of A319 and A320 Classics in favor of the A321, which we have increased by 10 in the first quarter compared to last year.

And on the part of our long-haul fleet, we continue to phase out especially the A330s and the A340s in favor of the newer technology. The main change here is that we have increased by seven our Dreamliner fleet. Two of those deliveries are 787-9s, which are the first two deliveries of those aircraft in Latin America, that we are already flying on the Santiago-New York route.

This new fleet obviously has an important benefit from a cost-per-ASK perspective with the new technology being between 15% and 20% more cost efficient on a cost-per-ASK basis than the older technology. And obviously an important -- or important from the passenger experience perspective since they have obviously all the new and modern interiors.

Another important element to highlight for this quarter is that actually just yesterday we priced the EETC -- our first EETC issuance. This was a \$1 billion offering that allowed us to finance 17 aircraft that we will be delivering in the second semester of 2014, up to and including -- sorry, the second semester of 2015, up to and including the first quarter of 2016. So with that we fully financed our aircraft deliveries until the first quarter of 2016, which is very good news.

This is also a landmark transaction for us. It is the first EETC issuance in Latin America. There is only five or six EETC issuances that have occurred outside of the United States, and of those this is the largest one at \$1 billion. The coupon on these offerings were 4.2% for the A tranche and 4.5% for the B tranche.

Finally, we just wanted to reaffirm our operating margin guidance for this full year, although the estimates that we had in terms of the macro environment, the fuel price, and the exchange rates that we had when we gave the guidance in early January 2015, those numbers have changed. We still feel comfortable that with the current macroeconomic backdrop and with the current fuel prices we can reach this guidance of between 6% and 8% for the full year 2015.



We maintain our ASK growth numbers at between 2% and 4% for the passenger business, and we have slightly reduced our cargo ATK growth numbers to a maximum of 0%. We are looking at possibilities of even reducing our cargo capacity by anywhere up to 2% during this year going forward. That reduction would occur mainly with our freighter fleet.

We are operating 15 freighter aircraft currently. We actually have 15 freighters, but we are operating 12. Three of them have been subleased to another operator, which is operating them outside of South America, and we continue to look at opportunities to sublease additional freighter capacity.

So we are -- what we expect to do is basically offset the additional belly capacity that we are seeing from the growth in our international operations by a reduction in our freighter capacity during this year.

That concludes all of the prepared remarks that we had for now and we will be happy to take any questions that you may have.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Savi Syth, Raymond James.

Savi Syth - *Raymond James & Associates - Analyst*

Good morning. Just on the cargo front, I was wondering if the comment about the products, decreasing product explored, if you could clarify what that was.

Gisela Escobar - *LATAM Airlines Group - IR*

Sorry the decrease? I didn't really get the question, Savi. Can you repeat it please?

Savi Syth - *Raymond James & Associates - Analyst*

Sure, Gisela. In the press release I think there was several factors discussed in the cargo front and I think there was a mention of certain products the exports declined, and I was just wondering what that was.

Gisela Escobar - *LATAM Airlines Group - IR*

Well, the main -- most of it has to do with sort of just the general competitive environment in cargo where we have been seeing an increase in capacity, having to do mainly with the increase in passenger flights to the region. The long-haul aircraft obviously have freight capacity so that has created some overcapacity in the region.

And in terms of the product, what we are mostly referring to and what has been mostly impact has been [seats]. We have certain seasonal products in cargo that are very relevant during certain months of the year. And where we have seen the biggest change already last year and this year as well is that during the months of March and April there's certain -- there's certain seasonal products that are strong having to do with perishable exports from the region as well as seats.

Savi Syth - *Raymond James & Associates - Analyst*

Got it. And just could you remind us the cargo mix evolution of that? And maybe is it possible to provide just, as you increase the belly mix, what kind of a contribution that could be to margins?

Gisela Escobar - *LATAM Airlines Group - IR*

Obviously, the belly part of the cargo operations is a more significant contribution because all the costs are already -- there's basically a fixed cost. There's only a very slight increase in costs to put cargo into your bellies that have to do with the additional freight handling at airports and with the marginal additional fuel that you need on the passenger flights to carry cargo in the belly.

So as we increase, as we basically weight our cargo more towards having -- focusing more on the belly than on the freighters, the overall contribution of the cargo business to the overall LATAM results will be higher, because basically it's just ancillary revenue when you look at the belly operations. The issue is that you need to maintain a certain amount of freight operation in order to feed that belly capacity.

We don't necessarily have cargo at all the different points that you fly to on the passenger side, so we need to maintain a certain amount of cargo flights in order to make sure that we can move cargo around the region to have it available to put on the passenger planes wherever they are departing from.

Savi Syth - *Raymond James & Associates - Analyst*

Got it, Gisela. If I may just ask one last one just on the cost side, is it possible to kind of disaggregate just how much benefit in the nonfuel costs came from currency and just how much came from the cost initiatives and maybe what the contribution from cost initiatives will be the rest of the year?

Gisela Escobar - *LATAM Airlines Group - IR*

For the full year, we would expect the contribution from our cost initiatives to ramp up. Our estimate is that over a three-year period we will reduce our total costs by approximately \$800 million run rate annually. We expect close to \$200 million of that to be recognized during 2015 as a whole and that is spread out in a series of different initiatives.

But it's very much, obviously -- in all the different cost lines there is a mix of both effects. If you wanted to calculate just the effect of the currency depreciation, you could estimate that approximately 40% of our costs are in local currencies, and that with devaluations of basically -- for about half of that being the Brazilian real, which devalued 20%, and half being the other currencies, which probably devalued on average 12%, I think.

Savi Syth - *Raymond James & Associates - Analyst*

All right, that's helpful. All right, thanks, Gisela.

Operator

Duane Pfennigwerth, Evercore.

Duane Pfennigwerth - *Evercore ISI - Analyst*

Good morning. Just on Brazil, it looks like -- based on the performance this quarter, the revenue performance this quarter and the margin performance this quarter and the reiteration of your margin guidance for the year, that while Brazil is weak, it's performing in line with maybe what you expected.

So I wonder if you could just talk about when you saw a step down in corporate demand in Brazil. Perhaps whether there was any incremental deterioration late in the first quarter and if it's behaving sort of as you expected on the outside of the year into the second quarter.

Claudia Sender - LATAM Airlines Group - President, TAM

This is Claudia. Let me try to answer your question; if I don't get everything you asked, let me know.

Yes, we did see a decline in corporate demand but that started way before the first quarter. It actually started right before the World Cup, and it didn't really pick up during the whole second semester last year and the first quarter this year.

What we have managed to do is maintain our corporate market share, which was important. And even with our capacity reduction compared to previous years, we have managed and retained our corporate market share so this has definitely help us manage the results or it had less -- feel a little less the drop in corporate demand.

We actually, looking forward, do foresee some sort of pickup, but it's too early to have real evidence of that. I think one of the key reasons why we have managed to maintain our corporate market share is due to the strength and depth of our network, which not only covers the domestic market but also the international markets. So for a regular corporate flyer we do have the best product available.

Duane Pfennigwerth - Evercore ISI - Analyst

That's helpful. If I could just -- if you think about the international portion, Brazil point-of-sale and I guess the month of March -- I'm not sure if you are willing to comment on the month of March in particular. But did you see sort of a step down in the month of March, with respect to corporate international from Brazil?

Nicolas Goldstein - LATAM Airlines Group - CEO, Long Haul Business

Yes, this is Nicolas Goldstein. What we observed is a decline during March. However, we were able to compensate this decline in Brazil with our network with passengers coming from Argentina, Uruguay, and other parts of the southern cone of America.

We have probably 35% of our passengers from Brazil coming from other point-of-sale, not Brazilian, and other competitors have probably 10% only of this. So our [capacity] really help us to stop this decline that we observe in Brazil right now. And we grew 34% in this, feeding from other countries, when we observed this new reality in Brazil.

Duane Pfennigwerth - Evercore ISI - Analyst

All right, that's great. Then if I could just ask you to expand a little bit more on what you mean by the early signs of a pickup, sort of what period that refers to? Is that a commentary on pricing? Is that international? Is that domestic?

But in terms of early signs of a pickup, any additional commentary you could offer there is great.

Claudia Sender - LATAM Airlines Group - President, TAM

What we have seen is that there has been in the first months of the second quarter some signs of price recovery, but it was no signs of demand impact. So we do see some uptick in corporate revenues going forward.



Duane Pfennigwerth - *Evercore ISI - Analyst*

Sorry, is that domestic or is that international?

Claudia Sender - *LATAM Airlines Group - President, TAM*

That's for both.

Duane Pfennigwerth - *Evercore ISI - Analyst*

Thank you very much.

Operator

Bernardo Velez, GBM.

Bernardo Velez - *GBM - Analyst*

Good morning, guys, and thanks for taking the time for the questions. Gisela, you mentioned regarding the guidance for 2015 that your macro and all the assumptions for the year had changed. I was wondering if you could provide us with a little bit more insight on these numbers.

Gisela Escobar - *LATAM Airlines Group - IR*

We had originally when we had first published our guidance we had assumed \$85 per barrel jet fuel for the year and a BRL exchange rate of BRL2.7 for the year.

Today, when we look at our estimates for the second half of the year, we are looking at fuel around \$77 per barrel for jet fuel. That's our current estimate. Obviously, it moves around. And on the real we are looking at somewhere around BRL3.10 for the second half of the year.

Bernardo Velez - *GBM - Analyst*

Okay, perfect. Thank you. I was wondering if you could give us a little bit more color regarding your hedging strategy and specifically in terms of FX variations.

Gisela Escobar - *LATAM Airlines Group - IR*

If you look at our strategy for FX hedges, we had, as you know, on the Brazilian real we have hedged at this point approximately \$695 million for 2015. So that is a significant part of our total exposure which we estimate at between \$750 million and \$800 million per year.

Bernardo Velez - *GBM - Analyst*

Okay, perfect. Thanks a lot.

Operator

Michael Linenberg, Deutsche Bank.



Michael Linenberg - Deutsche Bank - Analyst

Good morning, Gisela. Couple questions here. I want to go back to the cargo questions when you were answering for Savi.

You look at your freighter fleet and it's been shrinking, and I appreciate the fact that you've said that you have to maintain some freighters to sort of feed the bellies. Have we seen a structural change in cargo? As I look at the size of your fleet and how big that fleet is going to become, I mean we could be looking at maybe half a dozen freighters, maybe even lasts.

Is the world -- as we think about air cargo out over the next few years, maybe five years or so, is it going to be a world where you are just not going to have any freighters and it's going to all be belly capacity? Or is there going to be this need to continue to have a few freighters at your disposal?

Gisela Escobar - LATAM Airlines Group - IR

I think there has definitely been a structural change because of the amount of the significantly larger passenger aircraft. And if you look in general at the composition of freighter capacity worldwide, belly capacity for the first time is higher than freighter capacity. There has been, I think, a structural change in that sense as these larger passenger aircraft come in with significantly more capacity for freight.

From our perspective at LATAM, we had a structural change at the time that the merger between LAN and TAM occurred, because LAN had historically had a significant amount of freighter capacity available to serve the Brazilian market, which was no longer required when we were able to start utilizing all the belly capacity of the TAM long-haul flights. So, in general, we have moved to a focus almost exclusively on filling in the best possible way all of our belly capacity.

But we do see that there will always be, at least from our perspective, a need for a certain amount of freighters. We feel that the current amount of freighters that we have in our fleet, the 12 freighters that we are currently operating, we would still like to see that reduced. And if you look at our fleet plan going forward, we do expect that next year in 2016 we should be able to reduce two additional 767 freighters that will be able to return. That would put us at 11 freighters in operation at the end of 2016.

And we continue to look at opportunities to sublease some of that capacity, because with the current demand environment we don't see the need for so much. But we will require some of them, basically for two things. One, because there are certain routes that we won't fly on the passenger side that are very significant freighter routes. For example, certain European routes like Amsterdam for flower exports and things like that.

And on another hand, we need a certain amount of freighters to be flying within South America because we have -- for example, in Brazil, which is a very important import market for freight, doesn't have a significant amount of freight exports. So we need to take freight from our market, our other markets in the region to Brazil in order to fill up the belly capacity that is leaving Brazil. And that also requires a certain amount of freighter flights within the region.

I hope that answers your question.

Michael Linenberg - Deutsche Bank - Analyst

That's great, that's very comprehensive. Thank you.

Then just a second question. So I think US-Brazil Open Skies, I think it fully phases in -- is it early January 2016? I may be off with the date, but the question is it would seem with the amount of supply between the US and Latin America, and it has been growing, a lot of these -- with Open Skies agreements in place, a lot of times you will see key partners pursue antitrust-immunized joint ventures as a mechanism to really rationalize capacity.

It's interesting because we haven't really heard anything on the American LATAM front. I know that American does have the antitrust immunity with LAN with some various carve outs, but it would seem that there is a huge opportunity to do an ATI JV between American and LATAM. Like I said, I haven't heard anything on that front.

I sort of point to Delta and Aeromexico. January 1 is their day and they have already filed multiple applications. As you can tell, they want to fast track that process.

Where are you guys on that? And maybe the fact that American is going to this integration with US Airways it has actually slowed down your ability to push that through. When does it kick in, the full phase or the final phase? And where are you guys as partners in potentially pursuing that type of relationship?

Claudia Sender - LATAM Airlines Group - President, TAM

This is Claudia. Here in Brazil the full Open Skies still needs the ratification from the president, so we are waiting for that in order to move forward and make any announcement in the future. We are still waiting for the full ratification.

But just to make another comment on that, in the recent months what we have seen is actually the opposite of what you mentioned in the longer term. A lot of American carriers have been taking capacity away from the Brazil-US market, both American, United, Delta, so we have seen some capacity rationalization in the Brazil-US market.

Michael Linenberg - Deutsche Bank - Analyst

Okay, good. So we just have to wait for the president. And is that something that is imminent or could that -- that's one of those things where it could just drag on for some time?

Claudia Sender - LATAM Airlines Group - President, TAM

I don't think I'm in a position to answer to that. I think it depends on the presidential schedule, so it should happen this year, but it totally depends on the president.

Michael Linenberg - Deutsche Bank - Analyst

Okay, fair enough, Claudia. Thank you.

Operator

Daniel Guardiola, LarrainVial.

Daniel Guardiola - LarrainVial - Analyst

Good morning. I would like to touch on leverage and how you said that. I would like to know what are your thoughts on partially divesting your interest in LANPASS in order to accelerate the deleveraging process.

Gisela Escobar - LATAM Airlines Group - IR

That's not something that we are evaluating at this point in time.

Daniel Guardiola - *LarrainVial - Analyst*

Okay. If I can ask a follow-up question, I'd like to know what measures are you putting in place to reduce the volatility seen at the bottom line. And if you could please comment on what is the current amount of USD debt under TAM's balance sheet.

Gisela Escobar - *LATAM Airlines Group - IR*

In terms of these FX losses from a nonoperational perspective, as you correctly mentioned, they have to do with the fact that TAM in functional currency is in reals, so the balance sheet is in reals. We have seen that we have been able to reduce that over the past three years.

If you look at the TAM balance sheet, we have reduced that exposure from about \$4 billion at the time of the merger to approximately \$600 million today. So there has been a significant reduction. Now there is a portion of exposure that is on the LATAM sort of consolidated balance sheet to different currencies, including the real, which we're not able to mitigate as easily.

But what we have been able to do we have done and there is still a certain dash -- we still expect that \$600 million be reduced probably by -- we are aiming to be between \$300 million and \$400 million by the end of this year. And that is done basically (multiple speakers) in LATAM.

Daniel Guardiola - *LarrainVial - Analyst*

Okay, thank you.

Operator

Stephen Trent, Citi.

Stephen Trent - *Citigroup - Analyst*

Good morning, everybody, and thank you for taking my questions. This question might be one for Claudia.

I am just curious; you guys mentioned on the previous call this plan to I guess shift around some of your domestic Brazil capacity on to some of these regional routes that had stronger yield opportunities. And I'm just wondering, roughly speaking, where you are with that plan.

Claudia Sender - *LATAM Airlines Group - President, TAM*

Thanks for the question. We have already announced four new destinations here in Brazil, which are actually regional destinations. I don't know if you saw it, but Sao Jose dos Campos, Jaguarnua, Bauru, and (inaudible). Part of it has already been implemented; part of it is going to be implemented during the second quarter. They are all already on sale.

But I think the most importance thing that we have done in terms of reshuffling our network is strengthened our Brasilia hub, which we have found has been the optimal way of covering the flows within Brazil, within the domestic market. But also opens new opportunities to serve international destinations for the Brazilian inhabitants who live above Rio de Janeiro, who don't want to fly down to Sao Paulo and then up to the US, for example.

Just to give you one number, our connectivity in the last couple of years in the Brasilia Airport has increased by 25%. The number of destinations has grown from 30 to 48, but we have more than doubled the number of ONDs served by that airport. So the way we are looking at our network as a whole has changed quite significantly in the past two years, so it is definitely what we mentioned in the last call.

Stephen Trent - Citigroup - Analyst

Okay, Claudia. Very helpful and I did see the new routes. And I guess -- so part of the message is there's still more of this reshuffling to come, looking into 2Q for instance?

Claudia Sender - LATAM Airlines Group - President, TAM

Absolutely.

Stephen Trent - Citigroup - Analyst

Great, great, great. Very helpful, Claudia, thank you.

Just one very quick follow-up for me as well, for the general team perhaps. If you could refresh my memory where you are -- where TAM is or, excuse me, LATAM is in terms of taking TAM's fleet and parking them on the balance sheet in Santiago, where we are in that process. If you could just refresh my memory.

Gisela Escobar - LATAM Airlines Group - IR

Steve, we still have a little bit more to do on that front, but we have done I would say the most -- the large part of it. We have a \$600 million exposure on the TAM balance sheet still and we expect that we can reduce that to approximately \$300 million over the next three or four quarters.

Stephen Trent - Citigroup - Analyst

Okay. Thanks, Gisela. And I think when the carriers merged in mid-2012, the balance sheet exposure for TAM was something closer to \$4 billion. Does that sound right? Am not sure if I had the right number in my head.

Gisela Escobar - LATAM Airlines Group - IR

Yes, that's exactly right.

Stephen Trent - Citigroup - Analyst

Okay, great. Thanks, Gisela. I let someone else ask a question, but thanks for the time.

Operator

[Joe Mora], Bank of America.

Joe Mora - BofA Merrill Lynch - Analyst

Thanks for the call. I just have one quick question regarding the implementation of the fiber technology. If you could, please elaborate more on that; how long is it going to take before they are operational in TAN and LAM? And most important, we know that (inaudible) implemented an important change in its strategy and that they are using their (inaudible) technology.

Does the adoption of (inaudible) have an impact for (inaudible) at all? If not, why the adoption of a different technology in (inaudible)? Thank you.

Claudia Sender - LATAM Airlines Group - President, TAM

This is Claudia. We are working on the calendar for our implementation. It's something that could take at least two years, so we are looking at 2017 implementation. We want to make sure the implementation is seamless, with no impact on our revenues, on our clients, especially on the travel agents, so we want to make sure that we do it with no rush and with all of the benefits that it can bring us.

We are absolutely convinced that the technology will help us not only have a seamless experience between the two carriers, since we are moving into the same [hub], but also a much better experience for our clients.

In regards to multiples, we actually have to be connected and the new connections will have to be developed, so I don't see any difference and we will have to update you the connection between (inaudible) and the carrier but not necessarily change the entire (inaudible) platform. You can actually use (inaudible) products on (inaudible) platforms and vice versa.

Joe Mora - BofA Merrill Lynch - Analyst

Okay, thank you.

Operator

[Rein Paviv], Santander Asset Management.

Rein Paviv - Santander Asset Management - Analyst

Hello, everyone. Thanks a lot for the call. I was wondering if you can refer to the cost reduction of the Company, more specifically in items other rentals and lenders fees, where there are savings for about \$40 million compared with the first quarter last year on the item other operating expenses where there are savings for almost \$50 million. So we have almost \$100 million in cost reductions and the question is do you expect that amount of reduction in the following quarters? Thanks.

Gisela Escobar - LATAM Airlines Group - IR

Yes, thank you. We have -- I'd say those two lines in particular have a significant portion that are in local currencies. So a part of that has to do with the devaluation of the local currencies that when you look at it in US dollars, obviously you see that those costs are reduced.

On the other hand, we have also some initiatives that we have been implementing that have an impact there. A part of it has to do, especially when we look at the line of other costs, with a new transportation management system within the Company. It's a series of small initiatives that together add up to savings, especially when you look at it on an annual basis.

But we basically renegotiated all of the ground transportation contracts that the Company has throughout South America. We have also renegotiated our contracts with security guards in all the different parts -- in all the countries where we operate; our policy with transport vouchers and also we are looking at a new contract negotiation for our helpdesk.

Those are things that we have already implemented during the first quarter. We also have certain tax initiatives that have to do with the value-added tax in Brazil, where we have been able to recover them. And this has been ongoing. Part of this was done last year as well, but where we have been able to recover value-added tax of previous periods in Brazil, basically as a result of looking at the tax credits that we had generated in previous periods.

So it's a mixture of a series of different initiatives. We do expect our cost per ASK, ex fuel, to continue to decline for the rest of the year. I wouldn't be able to tell you if it will be with the exact same order of magnitude as during the first quarter, but we do expect that trend to continue going forward.

Rein Paviv - *Santander Asset Management - Analyst*

Excellent, thanks a lot.

Operator

Ari Friedman, Cobalt Capital.

Ari Friedman - *Cobalt Capital Management - Analyst*

Thanks a lot, guys. I wanted to ask a question about the other operating expenses. I see that was down on the reversal of tax contingencies in Brazil. I was wondering if you could explain a little bit what that is and if that is something that is sustainable going forward.

Gisela Escobar - *LATAM Airlines Group - IR*

That was sort of in line with what we were just discussing in the previous question. In Brazil, there is value-added tax that is basically paid with all -- on all different cost lines. But what has occurred, and what sort of we do on an ongoing basis, is basically a revision of the tax credits that were used in previous periods and that revision generates a tax credit for -- generated a tax credit this year as a result of rectifying the taxes that were created in previous periods.

This is ongoing in the sense that we do continue to do this review going forward on an ongoing basis, and we do expect that we will see a future benefit of this during the next three quarters and also on an annual basis going forward. Probably smaller than what we saw during the first quarter of this year. But a part of it is ongoing.

Ari Friedman - *Cobalt Capital Management - Analyst*

Great. And then one follow-up question; I'm not sure if I missed this. What is the constant currency yield estimate that you guys have embedded in the guidance?

Gisela Escobar - *LATAM Airlines Group - IR*

Right now, for the second quarter -- I mean for the second half of 2015, we are working with a BRL3.10.

Ari Friedman - *Cobalt Capital Management - Analyst*

No, not currency. For the actual constant currency yields, the actual pricing.

Gisela Escobar - *LATAM Airlines Group - IR*

We haven't disclosed that number.



Ari Friedman - *Cobalt Capital Management - Analyst*

Okay, thank you.

Operator

[Carlos Luro], JPMorgan.

Carlos Luro - *JPMorgan - Analyst*

Thank you for taking my question. I have just one very quick question here. Given the weakness of markets in LATAM, and especially in Brazil, I would like to know if you could give us a little bit of color on what you are expecting for the second quarter in terms of margins and traffic.

Gisela Escobar - *LATAM Airlines Group - IR*

As you know, we -- our guidance in terms of margins is only annual, so we can't provide too much detail regarding specifically the second quarter.

If you look historically at our margins on an annual basis, the second quarter is the low season, so we tend to have the lowest margins of the year in the second quarter. We would expect them, therefore, in that respect to be lower than obviously the guidance number that we have for the full year. It's the low season for all of our business units: domestic passenger, international passenger, as well as cargo. So that's generally weak.

Nicolas Goldstein - *LATAM Airlines Group - CEO, Long Haul Business*

There is going to be only a small twist used to -- we don't have the workup that affect us last year and this is going to affect only 15 days on June. This is the only different thing from last year.

Carlos Luro - *JPMorgan - Analyst*

Okay, thank you.

Operator

Savi Syth.

Savi Syth - *Raymond James & Associates - Analyst*

Thanks. Just wondering on the financing side, given the success of the EETC, I was just wondering if any thoughts have changed on -- I think last time you talked about maybe doing 50/50 finance and operating leases. Has that changed given the success of the debt raise?

Gisela Escobar - *LATAM Airlines Group - IR*

Savi, for now our fleet commitments both for 2015 and for 2016, our estimate is still to finance approximately 60% with the financing. Basically these EETCs and the remaining 50% with sale and leasebacks hasn't changed.

Savi Syth - *Raymond James & Associates - Analyst*

Okay, thanks so much.

Operator

At this time there are no further questions in queue.

Gisela Escobar - *LATAM Airlines Group - IR*

Great. Thank you all for joining the call today. If you have any follow-up questions, please contact us by telephone. Thanks very much and have a great day.

Operator

Ladies and gentlemen, thank you again for joining us today. Please feel free to contact our investor relations department if you have any additional questions. We look forward to hearing -- speaking with you again. Have a great day.

DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2015, Thomson Reuters. All Rights Reserved.