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LAN.SN - Q1 2019 LATAM Airlines Group SA Earnings Call

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PRESENTATION

Operator

Good day, everyone, and welcome to LATAM Airlines Group earnings release conference call. Just a reminder, this conference is being recorded. LATAM Airlines Group earnings release for the period was distributed on Thursday, May 16. If you have not received it, you can find it in our website, www.latamairlinesgroup.net, in the Investor Relations section.

At this time, I would like to point out that statements regarding the company's business outlook and anticipated financial and operating results constitute forward-looking comments. These expectations are highly dependent on the economy, the airline industry and international markets. Therefore, they are subject to change.

Now it is my pleasure to turn the call over to Mr. Ramiro Alfonsín, Chief Financial Officer of LATAM Airlines Group. Mr. Alfonsín, please begin.

Ramiro Diego Alfonsín Balza - LATAM Airlines Group S.A. - CFO & Senior VP of Financial Fleet

Thank you, Victor, and good afternoon, everyone, and welcome to LATAM Airlines First Quarter Earnings Call. Joining me today are Mr. Roberto Alvo, Chief Commercial Officer; Mr. Jerome Cadier, CEO of LATAM Airlines Brazil; and Mr. Andrés Del Valle, Vice President of Corporate Finance.

Please join me on the Slide 2, where you will find the highlights for the first quarter of 2019. LATAM faced adverse economic conditions during this first quarter. International demand slowed down, especially from Argentina and Brazil, influenced by the devaluation of their respective currencies, and by excess capacity in routes from Brazil to Europe and to the U.S. In addition, revenues per ASK in domestic operations decreased, exclusively due to the currency devaluation across Latin America. As a result, total revenues declined by 7.5% during the quarter. Excluding foreign exchange, revenues per ASK improved 7% in domestic Brazil and 3% in Spanish-speaking countries.

On the other hand, we continued working hard on our cost-saving initiatives. Cost per ASK decreased 6.9%, while cost per ASK, excluding fuel cost, decreased 8.7%. As a result, operating income for the quarter amounted to \$82 million, representing an operating margin of 3.3%.



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We are reacting to the weak international demand by reducing frequencies and suspending routes in international operations where demand has softened and in markets with overcapacity. As an example, we suspended our flights from Rio de Janeiro to Miami, the plans to fly from São Paulo to Munich, and we will suspend the flight from São Paulo to Rome in October. In addition, we are reducing our international supply to Argentina by approximately 20%, including the suspension of flights to secondary cities from Santiago and from São Paulo.

On the other hand, we will increase our growth in domestic Brazil due to the healthy demand environment and the capacity declines recently made by one of our competitors. For that purpose, we signed a lease contract for 10 additional aircraft, Airbus A320. As a result, we adjusted our capacity guidance for 2019. International growth plans are now in the range of between 0% to 2% and domestic Brazil between 5% to 7% for 2019. Our consolidated capacity growth will be between 3% to 5%, which compares with the previous growth plan of 4% to 6%.

Moving to recent developments. We were contacted by Elliot Management Corporation, the main creator of Avianca Brasil, to participate in a potential restructuring plan later approved by the judge and the creditors in April. The plan included an expected auction for May 7, but it was suspended and there's no certainty of the new time line. We will continue monitoring the opportunity to increase our presence in some attractive airports in Brazil, as we continue to see a healthy demand environment in the coming quarters.

On April 30, LATAM Airlines Brazil acquired a minority stake, thus owning 100% of Multiplus stock, and will now proceed with the integration of both companies. This will allow us to manage the program in a similar way to how we currently handle LATAM Pass, having the flexibility to offer the program members a better value proposition for redeeming their points and increasing the preference of our services.

Finally, on April 25, LATAM shareholders meeting approved the dividend distribution of \$54.6 million, which represents 30% of the net income of 2018. This is the third consecutive year of dividend payments after the association between LAN and TAM and the highest since then.

Despite the challenging quarter, where we saw international demand soften, we are strengthening our leadership in the region and the operations in our markets. We are growing in the domestic markets where demand is healthy, and we see attractive opportunities for our network, such as in Brazil, Peru, Colombia and Chile, and reacting to the challenging international market by adjusting our network accordingly. We are receiving the first aircraft with the new cabin, which will help us to maintain the preference of our passengers and a competitive product.

In summary, we are taking the right steps to consolidate our leadership and ensure the long-term sustainability of LATAM.

With that, I would like to turn the call to Andrés Del Valle, to see the first quarter in detail.

Andrés Del Valle Eitel - LATAM Airlines Group S.A. - SVP of Corporate Finance & IR

Thank you, Ramiro, and hello, everyone. Please turn to Slide 3, and here you'll see a final summary of the income statement. Total revenues of the company declined by 7.5% in the first quarter to \$2.5 billion. On the passenger side, even though we carried more than 800 additional passengers and capacity grew 6.7% during the quarter, revenues per ASK fell 12% in dollar terms. Devaluation of the local currencies affected international demand and revenues in domestic operations were measured in dollar terms. Currency devaluation also affected cargo revenues, which decreased by 10.9% due to lower imports to the region, especially to Brazil and Argentina. Finally, other revenues fell 19.6% to \$94 million due to the devaluation of the Brazilian real on Multiplus' revenues.

On the other hand, total cost declined by 0.7% in the quarter to \$2.4 billion. Excluding fuel, total cost declined by 2.6% and cost per ASK by 8.7%. Consequently, operating income for the first quarter amounted to \$82 million, which represents an operating margin of 3.2%, a decline of 6.6 percentage points compared with the same period of last year.

The nonoperating result amounted to \$126 million loss in the first quarter, almost the same as in the first quarter of 2018, while taxes were \$34 million lower than previous year due to a lower pretax income. As a result, net loss amounted to \$60 million in the first quarter 2019.

Please turn to Slide #4. As it was the case in the previous quarter, we continue to see a decline in unit revenue trends for both passenger and cargo, mainly as a result of the devaluation of local currencies year-over-year. Looking at each of the business units, you can see that international operations



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were affected the most. They represented approximately 57% of our total ASKs during this quarter, and we had a capacity growth of 8.1%. This growth was mostly driven by new international destination during 2018 such as Lisbon, Boston and Tel Aviv.

Traffic was up 5.5% and load factors declined 2.2 percentage points to 85.1%, mainly due to fewer Argentine passengers and overcapacity in long-haul routes from Brazil, especially to Europe. As a result, revenues per ASK were \$0.056. That is 15% lower than in the same quarter of last year.

On the domestic Brazil front, which represents 25% of total capacity, we had 1.5% increase in capacity and load factors were relatively stable at 82.1%. Revenues per ASK continued showing a recovery growing 7.3%, as measured in Brazilian reais, while measured in U.S. dollars, revenue per ASK declined 7.2% to USD 0.062.

Looking at the Spanish-speaking countries, domestic operations together representing 18% of our total passenger capacity. We grew capacity by 9.6%, while traffic increased 10.3% during the quarter, especially in Peru, Ecuador and Chile. As a result, load factors increased 0.5 percentage points to 84.2%. Revenues per ASK declined by 10.4% during the quarter mainly in Argentina, Colombia and Chile due to the devaluation of the Argentine, Chilean and Colombian pesos. Excluding foreign change effect, revenues per ASK would have grown 3% in the Spanish-speaking countries' domestic operations. As a result, our overall passenger capacity grew by 6.7% year-over-year this quarter. Revenues per ASK declined 12.3% year-over-year and load factor reached 84.2%.

Lastly, our cargo operations slightly reduced capacity, while traffic grew 1.9%. We saw an increase of 1.3 percentage points in the load factors to 56%. However, revenues per ATK declined by 10.6% in the first quarter mainly due to lower imports to the region, especially to Brazil.

Please turn to Slide #5. Here you can see that we continue delivering results on our cost-saving initiatives. We operated 6.7% more ASKs and carried more than 800 additional passengers during the quarter in a much more efficient way with fewer employees per aircraft.

During the quarter, our overall cost fall amounted to \$2.4 billion, a reduction of 0.7% compared to the first quarter of 2018. Fuel costs continue to show increases year-over-year, but contrary to the previous quarters, at this first quarter, the increase was due to an 8% increase in fuel gallons consumed, partially offset by a decline of 6.2% in fuel price per gallon, excluding hedges.

Costs associated with wages and benefits have decreased by 7.5% year-over-year, mainly driven by a reduction of 5% in the average head count for the quarter and the 16% and 98% devaluation of the Brazilian and Argentine currencies, respectively.

Regarding fleet cost, which include depreciation and amortization and maintenance expenses, they were up by 1.8% year-over-year in the quarter mainly due to 6 additional aircraft in our fleet as compared to the first quarter of 2018.

Lastly, other segment declined 2.8% year-over-year despite increasing operations as a result of our efficiency initiatives. As a result, cost per ASK decreased by 6.9% to USD 0.064, while the cost per ASK ex fuel declined by 8.7% year-over-year to USD 0.045.

Please turn to Slide #6. Here we can see some adjustment that we are making in our network during this year. As Ramiro mentioned, the main challenges we're currently facing are related to Argentine demand and international overcapacity in certain routes. Accordingly, we decided to stop serving the direct routes from Santiago and São Paulo to Tucumán in Argentina in March, while in the second half of the year, we will stop serving the routes from those same cities to Rosario, Argentina. In addition, we announced that the plans to serve new destinations such as Munich and Montego Bay were canceled and postponed, respectively, while the flight to Rome, launched last year from São Paulo, will remain operative until October of this year. With these adjustments, we expect to balance the capacity with the current demand environment.

On the other hand, we have seen attractive opportunities to densify our network in South America. We are improving the connectivity from our hubs in Lima and Santiago with other relevant cities in regions such as Cali, Brasilia or Quito. In addition, we have identified a target point-to-point route such as Guayaquil – Galapagos that we will start operating this July.



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Please turn to Slide #7. Our customers continue recognizing LATAM for the ultimate travel experience that we offer to our passengers. This reflects the efforts that we continue to put in all the steps of the travel and reaffirms our commitment to improve the travel experience of our passengers. We have been recognized for the second year running as the best global airline in South America by the Passenger Experience Association of Airlines, APEX, Passenger Choice Awards. LATAM was also recognized for the Best Seat Comfort, Best Cabin Service, Best Food and Beverage, Best Entertainment and Best Wi-Fi in South America. In addition, the readers of the publication PAX International chose us as the airline with the best catering service in South America for the second year running.

Please turn to Slide #8. Regarding our financial metrics shown on Slide 8, our gross debt reached \$7.6 billion and we're levered at 4.3x. We continue having a very good liquidity position with \$1.5 billion of cash on hand plus \$575 million of revolving credit facility, which is totally undrawn as of today. With this, LATAM's liquidity position reached almost 21% over the last 12 months' revenues. Our debt maturity profile, shown at bottom of the slide, shows a remainder of around \$770 million payable in 2019 and \$1.5 billion for 2020 due to the maturity of the unsecured 2020 notes of \$500 million.

Please turn to Slide #9, which shows our fuel hedging portfolio. For the first quarter of 2019, we had approximately 67% of estimated fuel consumption. For 2019, we have a good portion of our estimated fuel consumption hedged, with 65% hedged just for the second quarter, 42% for the third quarter and 20% for the last quarter of this year.

Finally, regarding our guidance, please turn to Slide #10. We have adjusted the capacity guidance for 2019. The main change is the lower growth for the international operations considering the adjustments previously discussed during the presentation. We expected growth for international market between 0% to 2%, which compares to a previous growth plans between 3% to 5%. In addition, we have increased the capacity growth for domestic Brazil operations, moving from a range between 2% to 4% to now a range between 5% to 7%. We're not changing our capacity guidance for our domestic Spanish-speaking countries, which remains between 8% to 10%. As a result, total growth for 2019 will be between 3% to 5%.

Regarding the cargo segment, capacity for 2019 will be in the range of 0% to 2% as a result of the adjustment made to the international capacity on the passenger aircraft. Our operating margin guidance remains unchanged between 7% to 9%. We see a better second half of the year due to more balanced markets between demand and capacity as well as more stable currencies.

And this concludes our presentation. And now we will be happy to open the line for questions. Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question will come from the line of Savi Syth from Raymond James.

Savanthi Nipunika Syth - Raymond James & Associates, Inc., Research Division - Airlines Analyst

Just a question on Brazil. I'm a little unclear. Is the increased capacity just backfilling some of the routes that Avianca Brasil has pulled back and not related to kind of the potential auction? And therefore, if you do get some of the Avianca Brasil assets, could we see that capacity going up? I'm just wondering if you could talk a little bit more within that -- the trends that you're seeing in Brazil as well.

Roberto Alvo Milosawlewitsch - LATAM Airlines Group S.A. - SVP of Commercial

Yes, Savi, this is Roberto Alvo. As you know, the results of the auction are unclear. So the final draw of the network as per the additional capacity, of course, hasn't been totally refined yet. But we see important opportunities, both in the routes we operate today and in potential additional markets to place the aircraft that Ramiro mentioned before during the second half of this year. So if you count the previous guidance together with the added capacity coming from those aircraft, that brings the new guidance to 5% to 7%, as explained before.



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Savanthi Nipunika Syth - *Raymond James & Associates, Inc., Research Division - Airlines Analyst*

And just any color on what you're seeing today from fare environment in Brazil?

Roberto Alvo Milosawlewitsch - *LATAM Airlines Group S.A. - SVP of Commercial*

Fares have been increasing in the last few weeks. But the market, I would say, still very difficult to forecast where it will stabilize at this point in time. But we see double-digit RASK growth in real terms for the second quarter as of the bookings we have today.

Savanthi Nipunika Syth - *Raymond James & Associates, Inc., Research Division - Airlines Analyst*

Very helpful. And if I may ask a question. In the last quarter, on the nonfuel unit cost, the thought was maybe it will be flattish. And you saw a good performance here in 1Q, and I'm guessing second half is a little bit tougher comp. Are you still thinking twice for the year? Or has your view changed from a nonfuel unit cost standpoint?

Roberto Alvo Milosawlewitsch - *LATAM Airlines Group S.A. - SVP of Commercial*

I'm sorry what type of cost?

Unidentified Company Representative

It should be...

Savanthi Nipunika Syth - *Raymond James & Associates, Inc., Research Division - Airlines Analyst*

The CASK, yes. I think in the last call, you thought maybe it was flattish for 2019. And I was wondering if that's still the thinking?

Ramiro Diego Alfonsín Balza - *LATAM Airlines Group S.A. - CFO & Senior VP of Financial Fleet*

Yes. That's still the thinking at this point, Savi. This is Ramiro.

Operator

And our next question comes from the line of Duane Pfennigwerth from Evercore ISI.

Duane Thomas Pfennigwerth - *Evercore ISI Institutional Equities, Research Division - Senior MD*

Just on the recent aircraft deal, the leases that you're assuming, I wonder why does it makes sense to take incremental leased aircraft versus just reallocating some of the existing 240 Airbus family narrow-bodies that you have?

Roberto Alvo Milosawlewitsch - *LATAM Airlines Group S.A. - SVP of Commercial*

Thanks. This is Roberto, again. So we haven't until now made a final decision if those 10 aircraft will go specifically to the Brazilian market. And at this point in time, both in Chile, Peru, and as previously said, in Colombia, we see good market opportunity. So we believe that we can locate these

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traditional aircraft within our different business units without impact to the current RASK and seeking important opportunities that we see going forward.

Duane Thomas Pfennigwerth - *Evercore ISI Institutional Equities, Research Division - Senior MD*

So you felt like you had a need for incremental A320 lift and this was just -- was it -- just the terms on this were so attractive? What was it about this deal?

Roberto Alvo Milosawlewitsch - *LATAM Airlines Group S.A. - SVP of Commercial*

I think that at this point in time, we see, outside of international and in some domestic market, obviously excluding Argentina, good market opportunities both in Brazil and in these countries, and we believe that it's a good opportunity to place that additional capacity. I would not comment on terms of the lease, of course.

Duane Thomas Pfennigwerth - *Evercore ISI Institutional Equities, Research Division - Senior MD*

Got it. Got it. And just with respect to how we're starting the year with this first quarter under our belt, would you say that we're tracking maybe more toward the lower end of the full year margin guidance?

Ramiro Diego Alfonsín Balza - *LATAM Airlines Group S.A. - CFO & Senior VP of Financial Fleet*

Duane, this is Ramiro. I think that is a correct assumption. We believe this year has started very challenging. We know that the second half of the year, it's a better comparison. You know that the currencies have started depreciating in the second half of 2018, in particular in the Argentine peso in the real itself. The Argentinian Paso in the last second semester depreciated by almost 100%, so the comparison is a little bit better. But yes, I would tend to think on the lower end of the guidance.

Operator

And our next question comes from the line of Matt Fallon from Deutsche Bank.

Michael John Linenberg - *Deutsche Bank AG, Research Division - MD and Senior Company Research Analyst*

It's Mike Linenberg on for Matt. I guess I have 2 questions. I guess the first one, this morning, I think we saw the headline that IATA has suspended Avianca Brasil from the bank settlement plan. And usually, when we see that, that usually is the beginning of the end. And I'm just curious about where things would stand from a liability perspective vis-à-vis the whole Avianca Brasil auction process. And what I'm getting at is that I believe you have lent them a certain amount of money. I think it was \$13 million. And the \$70 million would be if you were successful in bidding for one of the units. If the auction doesn't happen because Avianca Brasil shuts down in the next 24 to 48 hours, what are you on the hook for? Is it just \$13 million? Is there a breakup fee? Like what is the full liability that LATAM will have to -- what are they on the hook for essentially, even if nothing happens, if we -- if there's no auction, et cetera? Can you just give me a sense on that?

Ramiro Diego Alfonsín Balza - *LATAM Airlines Group S.A. - CFO & Senior VP of Financial Fleet*

Michael, this is Ramiro. If the Avianca auction would not happen, what we have committed to Avianca itself is \$13 million. That was already provided for and it was oriented mainly to working capital needs that the company had. But we also have in that same commitment in the same agreement we have reached with Elliot Management we disbursed a commitment of \$35 million. We didn't disburse all of it yet, but we have that commitment

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of \$35 million. And if there is a closing at the end of the day and there is an auction, we would get those \$35 million and those \$13 million back. If the auction does not happen, the total commitment that we currently have is \$35 million plus \$13 million.

Michael John Linenberg - *Deutsche Bank AG, Research Division - MD and Senior Company Research Analyst*

Okay. That's great. So that's capped. That's capped at that \$48 million. So that would be the extent of it. Then presumably there would probably be some allocation by the government of some of the scarce assets of Avianca Brasil to the incumbent carriers. That probably would be a potential scenario, I -- that could play out, I presume.

Jerome Paul Jacques Cadier - *LATAM Airlines Group S.A. - CEO of LATAM Airlines Brazil*

Mike, this is Jerome from Brazil. We don't know exactly what will be the position of the government regarding the passengers that do hold an Avianca ticket today, if the company goes to auction or if the company does not succeed in getting to the auction. So this is unclear today how the government will deal with that potential situation there.

Michael John Linenberg - *Deutsche Bank AG, Research Division - MD and Senior Company Research Analyst*

Okay. Great. And then just my second question. When I look out in the forward schedules, it does look like that you're adding a decent amount of frequency in some Colombian domestic markets, some of the bigger markets. And my question is, why now, the timing? And I know it's probably over the next couple of months where it looks like you really ramp up the frequency in the Colombian domestic market. I know that you've always had a good presence there, and I think you're a strong #2 in that market. Is it just the timing or just being opportunistic that there are domestic markets there that you feel like you can gain more share? Like, what's driving that decision, that larger move into the Colombian domestic market?

Roberto Alvo Milosawlewitsch - *LATAM Airlines Group S.A. - SVP of Commercial*

Mike, this is Roberto. Yes. I think we announced this 3 months ago, and we discussed a little bit on the prior call. We basically devoted 2 aircraft, a little bit more than 2 aircraft to domestic Colombia, mainly focused in the business routes, the most important business routes in Colombia. Our belief is that we see that there is an interesting and important opportunity of becoming a real alternative to the domestic business traveler in Colombia. I think that we've done our homework throughout the last years to putting ourselves in that position. And that together with the JVs, with both American and IAG, and our own international network we believe also provide a very interesting value proposition for those same passengers for international routes. So that's the growth we are foreseeing in the second semester of 2018 (sic) [2019] and that's the reason.

Jerome Paul Jacques Cadier - *LATAM Airlines Group S.A. - CEO of LATAM Airlines Brazil*

Mike, just -- Jerome again, just clarifying on an earlier question you had around Brazil. I did answer around the passengers, but Ramiro pointed me that the question was around the slots as well. So what we expect, if there is no auction, what we do expect is that an act follows the current rules, which means the slots go back to the pool and are then distributed to the current players. So that's the alternative scenario in case there is no auction.

Operator

And our next question comes from the line of Victor Mizusaki from Bradesco.



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Victor Mizusaki - Banco Bradesco BBI S.A., Research Division - Research Analyst

I have 2 questions here. The first one, when we take a look on your current aircraft fleet, we can see like 9, 11 subleased aircraft. So my first question is, can you disclose when these contracts will expire? And my second question, think about yields and load factor. I mean we can see a very high load factor of 82%, 84% in domestic Brazil and Spanish-speaking countries, but even considering this high load factor, we continue to see operating margins under pressure. So I'd like to understand, why did you started to increase capacity and opt to continue to raise price?

Ramiro Diego Alfonsín Balza - LATAM Airlines Group S.A. - CFO & Senior VP of Financial Fleet

So regarding -- if I understood correctly your question is, when are the subleases due? Is this the correct question?

Victor Mizusaki - Banco Bradesco BBI S.A., Research Division - Research Analyst

Yes.

Ramiro Diego Alfonsín Balza - LATAM Airlines Group S.A. - CFO & Senior VP of Financial Fleet

Okay. You see them -- for instance, in 2019, you see that we had 3 A350s leased and this will be -- 2 will be returning in 2020 and the remaining 1 will be returning in 2021 and that is why we will not have any more A350s leased. Regarding the 320s, they will continue to be leased until for 4 years and the Boeing 76s will continue to be leased in the medium term. There's not any specific deadline. That's a renewed contract that we have with one company to sublease these 2 freighters.

Roberto Alvo Milosawlewitsch - LATAM Airlines Group S.A. - SVP of Commercial

Yes. Regarding the end yields and load factor on domestic Spanish-speaking, so I think a few things to point out. First, as you probably know, there's a Peruvian company that ceased operating late last year called LC Peru and also we saw a retraction of Avianca Peru in that domestic market. That freed up a significant number of slots in Lima airport. Lima airport is extremely congested and today it's fully congested in the peak times. So one of the things we did is that we took the opportunity of increasing our presence in the Lima airport by taking out a good portion of those remaining slots. And that's one of the reasons why you're seeing an increasing capacity in domestic Spanish-speaking.

The second thing is that as you know we have important level of competition in domestic markets, Spanish-speaking type, particularly in Chile and also to some extent in Peru with local carriers, and we believe that we are effectively competing with them at this point in time. We're getting higher load factors than that they have. And as Andrés also explained, if you take out devaluation of the currencies, actually the RASK in local currencies is positive. It's over 3%. So it's the combination of the opportunities we're seeing in the market with our competitive position and the way we are trying to hold the leadership in the most important markets in Spanish-speaking side.

Operator

And our next question comes from the line of Petr Grishchenko from Barclays.

Petr Grishchenko - Barclays Bank PLC, Research Division - Fixed Income Analyst

I'm just curious, how comfortable are you with your current fleet commitments given lower guidance for ASK this year? And I guess we saw some of your competitors rescheduling deliveries aggressively, following signs of weakness, weaker-than-expected international traffic. And if I recall correctly, I think you cut your commitments by \$2 billion last quarter. So I'm just curious if you can provide some more color on how you're thinking of commitments now.



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Ramiro Diego Alfonsín Balza - *LATAM Airlines Group S.A. - CFO & Senior VP of Financial Fleet*

Thank you, Petr. This is Ramiro. And yes, we're constantly reviewing our fleet commitments. For this year, we originally expected to be a little bit north of \$1.1 billion of total fleet commitments. And that is always being reviewed according to market conditions. So maybe in the future, we have a recent update to provide you. At this point, we still have the same fleet commitments that are -- according to market conditions, gives us enough flexibility to move forward these next 2 years.

Petr Grishchenko - *Barclays Bank PLC, Research Division - Fixed Income Analyst*

Got it. And maybe can you discuss, you've got flexibility in terms of adjusting your operations, in terms of showing weaker or like softer international capacity and higher domestic Brazil? Do you think you can reshuffle the fleet in the sense that you don't have to change your commitments?

Roberto Alvo Milosawlewitsch - *LATAM Airlines Group S.A. - SVP of Commercial*

Yes. That's the case. A good example, I would say, is that the reduction of capacity that we have seen towards Argentina, and that Ramiro pointed out, which is around 20% international, we redeployed a significant portion of that capacity into domestic Peru for the conditions I told in the previous question. So yes, we do move our aircraft around. We have quite a high level of flexibility of doing that. And we, of course, reshuffle it as we see how the market changes.

Operator

And our next question comes from the line of Stephen Trent from Citi.

Stephen Trent - *Citigroup Inc, Research Division - Director*

Two for me. One, could you-- and apologies if I missed it, but could you give us an update as to the legal challenge that your Joint Business Agreement is facing that you, American and British Airways are planning? And what's the latest in terms of the challenge in Chile?

Roberto Alvo Milosawlewitsch - *LATAM Airlines Group S.A. - SVP of Commercial*

Yes. So the JV was reviewed by the Supreme Court. Remember that the JVs is in Chile -- were taken to the Supreme Court last year by a number of people. They were reviewed in the Supreme Court about 40 days ago. The Supreme Court says in their website that they have an agreement on this and they will issue at some point in time in the next few months their final decision. That's the only relevant or the only approval that we need for having all the approvals necessary for the JV with IAG, so South America to Europe. And also in the last weeks, we refiled our petition with the DOT. Our petition was filed 3 years ago and we basically updated it after Brazil cleared out Open Skies with the U.S. last year. We submitted that to the DOT, and we expect the DOT to take the normal timing which is around a year to have a final say. Those are the 2 regulatory steps that are pending on both the JVs on American with the DOT and Chile and with IAG only in Chile.

Stephen Trent - *Citigroup Inc, Research Division - Director*

Okay. Very helpful. And just one other question, kind of a question for Jerome, maybe a follow-up, to some extent, on Mike Linenberg's question about the Avianca Brasil slots. Assuming at this point that the ANAC seizes the slots and redistributes them, would you or would you not expect some antitrust scrutiny LATAM and go getting more slots, for example, with those 2 airlines having overwhelming market share in Congonhas as it stands today?



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Jerome Paul Jacques Cadier - LATAM Airlines Group S.A. - CEO of LATAM Airlines Brazil

Stephen, we -- according to the past, the process of slot redistribution has gone through ANAC's normal procedure, and we do not expect that [CADE] will interfere in that. It is possible, but we do not expect that to happen. In the case of a redistribution, it will follow the current rules that are already part of ANAC's definition. So it is Brazil, a lot of things are possible. But our scenario is that in the case of the auction that it does not go through, then the current rules are applied by ANAC as it was in the past.

Operator

And our next question comes from the line of Sebastián Ramírez from Banchile.

Sebastián Ramírez

The first one comes a little bit more related with the strategy. You pointed out that during the second half of the year, you will sharply reduce your ASK growth in international markets and also accelerate your growth in Brazil. So I wanted to understand, what were your -- the other incumbents in both segments doing in that respect? And how easy do you think that will be for Brazilian market to receive your acceleration in growth there? And also, I would like to ask you a few questions about IFRS 16 and the effect on the EBIT figures that we observed. I'm having some troubles to make those 2 numbers to compare themselves, EBIT for 1Q '18 to '19. So if you can give me some color on that, that will be great.

Roberto Alvo Milosawlewitsch - LATAM Airlines Group S.A. - SVP of Commercial

So with respect to the strategy and if I understood your question correctly and you mentioned incumbents, first, we don't give an opinion on the strategies on what our competitors to. And just -- I think that just at one point in the case of domestic Brazil, Avianca was operating approximately 50 aircraft in the beginning of the year in domestic Brazil. Their current operation is below 10 aircraft, so that's the size of the decrease of the operation in that market. And as we explained previously, our increase in ASK for domestic Brazil is 5% to 7%.

Ramiro Diego Alfonsín Balza - LATAM Airlines Group S.A. - CFO & Senior VP of Financial Fleet

Sorry, Sebastián, I was going to address the IFRS question, but if you have another question, please go ahead with that.

Sebastián Ramírez

No, no, it's -- that's perfectly right. I'm okay, with the first question. So IFRS 16, just wanted -- need to reconcile the numbers of 1Q '18 with the one that we're serving right now?

Ramiro Diego Alfonsín Balza - LATAM Airlines Group S.A. - CFO & Senior VP of Financial Fleet

What we have presented in the figures on the press release is an adjusted first quarter 2018 with IFRS. So it's fully comparable. So when you see first quarter 2018 and first quarter 2019 in these figures in the press release and in the financial statements that we have provided to the market, they're both comparable. So you can fully compare it. The main difference, as you know, is that interest -- rentals is divided in depreciation and in interest and roughly it's \$90 million of additional depreciation and \$40 million of additional interest and you eliminate the rentals that you used to have in the EBIT margin. That's the main difference. We can follow up later if you want more detail.

Sebastián Ramírez

Definitely. On that sense, if we were to adjust last year margins to make it equivalent to the EBIT margins that you're projecting right now, so last year, we should add up something close to 1% to 1.5% to the figures that we have served previously?



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Ramiro Diego Alfonsín Balza - LATAM Airlines Group S.A. - CFO & Senior VP of Financial Fleet

Very similar, yes, very similar to 1.5%, ex IFRS.

Sebastián Ramírez

That's right. Yes. Okay. Super clear. One last question that we were referring to RASK in local currencies for the whole network and both in Brazil and SEC were growing in a positive way in local currency, what about CASK ex fuel in local currencies or just in those markets? What is the evolution that we should expect over there?

Ramiro Diego Alfonsín Balza - LATAM Airlines Group S.A. - CFO & Senior VP of Financial Fleet

Yes. For the first quarter, CASK improves a little bit, even without the foreign exchange impact. So it improves. We have a small efficiency, I would say, that of the whole impact in CASK that you see, I would say, 75% is foreign exchange rate and 25% is effective efficiency. And going forward, as I told Savi, we are still sticking to maintaining our cost per ASK during this year, which is a challenging target.

Operator

And our next question comes as a follow-up from Savi Syth from Raymond James. And our next question comes from the line of Bruno Amorim from Goldman Sachs.

Bruno Amorim - Goldman Sachs Group Inc., Research Division - Equity Analyst

I just have a follow-up question on IFRS 16. Just wanted to check if your prior guidance was also provided under IFRS 16 standards or not. I'm just trying to understand if you're maintaining the EBIT margin guidance range on a comparable basis or not?

Ramiro Diego Alfonsín Balza - LATAM Airlines Group S.A. - CFO & Senior VP of Financial Fleet

No problem, Bruno, this is Ramiro. And yes, we have been very clear that when we provided guidance last year, we were including the IFRS 16 impact on those numbers. So the 7% to 9% that we provided includes IFRS 16.

Operator

And our next question comes from the line of Savi Syth from Raymond James.

Savanthi Nipunika Syth - Raymond James & Associates, Inc., Research Division - Airlines Analyst

Sorry about that. Just a question on cargo. I was just wondering, I understand your view on kind of second half taxed cargo, is it similar trend where second half comps are easier? Or how should we think about what you're seeing on cargo and your expectations that you have through the year?

Roberto Alvo Milosawlewitsch - LATAM Airlines Group S.A. - SVP of Commercial

Yes. So this is Roberto again. First half of 2018 was the best period of time we've seen in cargo in many years. And the demand, particularly southbound, started decreasing toward the second half of 2018 due mostly to the situation in Argentina and to the devaluation in Brazil. So the



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comparison for first semester of this is quite challenging, but we've already seen -- we already saw in the second semester of 2018, an important slowdown on cargo, mostly southbound. Northbound cargo has remained relatively stable over the past 12 to 18 months.

Savanthi Nipunika Syth - *Raymond James & Associates, Inc., Research Division - Airlines Analyst*

That's helpful. And then just on the fuel hedging, it looks like you've kind of moved away from the fuel hedging there. Is that kind of related to balance sheet as you make some of these acquisitions and things like that? Or what's your latest thinking on the hedging strategy?

Andrés Del Valle Eitel - *LATAM Airlines Group S.A. - SVP of Corporate Finance & IR*

No. Andrés here, Savi. On the contrary, we're still maintaining the same policy. If you look at the chart here, we still have 65% for Q2, 42%, so still pretty much the same with same instruments 3-, 4-way instruments which protects in case of a downside. And today, I would say, the expected, I think, compensation is slightly neutral to positive at today's curve.

Savanthi Nipunika Syth - *Raymond James & Associates, Inc., Research Division - Airlines Analyst*

Okay. I guess I noticed you haven't really added anymore into 1Q. Are you not layering as much as you were given the runoff maybe? Is that...

Andrés Del Valle Eitel - *LATAM Airlines Group S.A. - SVP of Corporate Finance & IR*

Yes. That's a fair statement, yes.

Operator

Thank you for joining us today. Please feel free to contact our Investor Relations department if you have any additional questions. We look forward to speaking with you again soon. Everyone, have a great day.

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