

Operator:

Good morning, ladies and gentlemen, and thank you for holding. Welcome to Smiles' conference call to discuss its results during the 2Q19.

Following the Company's presentation, we will begin the questions and answers session. If you would like to ask a question, please, dial *1. If you require any assistance during the conference call, please call an operator by dialing *0.

Please be advised that information given during this conference call may contain forward-looking statements or statements about future expectations. Such information is subject to known and unknown risks and uncertainties that may cause them not to materialize, or to be substantially different from what we expected.

Today we have with us Mr. Andre Fehlauer, CEO, and Mr. Marcos Pinheiro, CFO.

We will now give the floor to Mr. André Fehlauer. Sir, please, proceed.

André Fehlauer:

Good morning everyone. It is a pleasure to be here with you to share the highlights for our 2Q19 results at Smiles. I would like to thank you for listening into our call.

I will begin with the operational and financial highlights for the quarter shown on slide 2. Our gross billings continued to grow strongly, 23.9% in comparison to the 2Q18, and we reached a record R\$684.3 million. Our relationship has always been very close to our financial partners, and this contributed once again to this evolution.

Our redemption revenue grew by 33.7% due to a higher demand for air tickets during this period. And although it was a challenging period, our CRM and pricing departments were doing a very good job along with our dynamic pricing model, meaning that we reached historical levels of redemption revenues.

We had a growth of 0.5% in direct redemption margins in comparison to the 2Q18, and due to a drop in the Selic, our financial results were 13.3% lower than the same quarter in 2018, reaching R\$33 million.

Our net income was R\$155.7 million, which is 36.4% higher in comparison to the same quarter last year.

We have a commitment to growth and generating value to our shareholders. So, to continue, on slide 3, last week we announced two new airline partners: TAAG and Air Europa. This extends our number of airline partners to 20, reinforcing our commitment to diversify our business, and also having new routes to Europe and Africa. We have also strengthened our partnership with South African Airways and now our clients can accrue miles when flying with this company.

Slide 4 shows the 20 airline companies that we have with Smiles that offers flights to over 1,000 destinations. We are having now a complete offer for our travelers, which has always been our focus.



Slide 5 continues discussing the travelers' universe and their journey. This quarter, we started a new partnership with Gray Line, which is the largest provider of sightseeing tours in the world, and who has 2,500 products available worldwide, so they can accrue miles and redeem them with Gray Line when purchasing with a credit card. It is a similar model to what we have with hotels and car rental companies.

This partnership is already in operation and is available on our website, and it extends our offer of travel and entertainment options to make our travelers' trips more complete.

Slide 6 shows the new features of our app. From now on, Smiles' clients will be able to transfer miles using the app, and an important demand that we have was to seek promotions.

We as a Company have several promotions and now, they can see which ones they are taking part in through the app, so it really helps our clients and provides them with a better experience. Our app is definitely the most complete one in the industry.

The idea is always to add improvements to platforms so that we can provide an even better experience to our clients. Ticket redemption levels have been growing month-by-month through the app and this has proven how successful we have been in focusing our relationship through the app.

Slide 7 shows some news for Smiles in Argentina. This quarter, we launched Clube Smiles, that is a product that we pioneered here in Brazil and now we are also launching it in Argentina. Just as it does in Brazil, you can accrue miles monthly through a subscription and there are different promotions for our members as well.

Another product that we launched in Argentina was Buying Miles. Now, Smiles' clients in Argentina can buy miles and supplement their balance, if they need to, to purchase tickets.

And we also supplemented our partnerships with banks there and other local partners. Now we have a partnership with American Express, Patagonia Bank, and we will soon begin our partnership with Galicia Bank, one of the largest local banks in Argentina.

These products show our commitment to following in the travelers' route in Brazil and Argentina. We are offering to Argentinian clients the solutions that we already provide here in Brazil. It is a strategy that was very successful here, so we will follow that same path there.

Now our Investor Relations Director, Marcos Pinheiro, will talk about our results in depth. Thank you.

Marcos Pinheiro:

Thank you, André, and good morning, everyone. Let us continue with slide 8. I would like to take this opportunity to invite our 150 listeners to look at the upper-left part of the slide. If you have never been to Florianópolis, we would like to invite you to go there. You can subscribe to Clube Smiles and issue tickets for only 3,800 miles, helping us, once again, to deliver more results.

Looking at the quarter's results, as André said some slides ago, we are seeing the Company's total gross billings, which were very positive this quarter, a 9% increase with regard to the last quarter. And let me compare to the last year, it was a growth of around 24%.

Slide 9 shows, once again, a destination. Porto Alegre is a very good city to visit, known for its cuisine, and if you want to see it, we will make it easier for you.

Regarding direct redemption margins, which is the main topic here on this slide, we see some more consistence. Once again, we were very efficient in our group that provides pricing and CRM to have consistent margins along the lines we saw in the previous quarters. And this despite a very difficult scenario with a lot of competition, as you know.

On slide 10, we see the Company's net income for this quarter. The quarter closed at R\$156 million, and net income, once again, with an evolution of over 9%. In comparison to the previous year, it was a very expressive increase, 36%, but you might remember that the 2Q18 was atypically low because of the breakage revenue we had at the time.

But all in all, results are still in line with our commitments to make management that creates value at Smiles. Our commitment is to continue engaging with more clients and to provide a better experience for travelers.

I would also like to invite you to see Brasília. If you have never been there, take a look at the destination.

We will continue with the questions and answers session, and we will be happy to answer any questions you may have. Thank you.

Victor Misuzaki, Bradesco BBI:

Good morning. I have two questions. Thinking about how these results will be continued in the future, can you provide any updates with regard to the negotiation with GOL in adjusting ticket prices?

And the second question is, when can we expect any news about an updated business plan?

Marcos Pinheiro:

Thank you for questions. Regarding transfer price, I really cannot say anything. We are working on it. I would just like to reinforce that this is a topic that we are dealing with very seriously. It follows the Company's governance that has been established since 2013. So any updates, as the Material Fact that we published regarding an update to those transfer prices, will follow the same governance.

We would like to highlight that this operation, when it does take place, will be approved by our Board of Directors. So, on our side, I would just like to reinforce that we are absolutely at ease about this. But unfortunately, I have nothing to say today.

Victor Misuzaki:

I have just have a question about that, regarding timing. Can you say anything about the short term? Will anything happen with regard to that discussion, with this negotiation?

Marcos Pinheiro:

I really cannot say absolutely anything about our expected timing. What I can say is that we are working very seriously. We have been doing it, but it follows a different governance and dynamic, which is normal to this process. It is long, it is extensive.

Just to give you an idea, when we go through this process ordinarily, it takes about three months to update accounts. It is not something that you can do at the blink of an eye.

But I can ensure transparently that we are working on it, and as soon as it is ready for our Board of Directors and the independent committee, the Company will make this known.

Victor Misuzaki:

And is it retroactive? For example, if it takes two more months, considering the date it was requested, is that the date when it will begin being enforced? Or is it when it will be approved by the independent committee?

Marcos Pinheiro:

The independent committee will analyze that request and define how readjustments will be applied. My understanding is that the reference date is the date of request. But it is not the Company's Board that decides that, it is the independent committee that will take a look at that request for extraordinary adjustments.

It is very similar to what happens ordinarily. If you remember our contract, we reimbursed the cost of opportunity that parties had in previous periods.

So regardless of the decision that the independent committee makes, the financial importance will be passed on to the transfer price. Whether it is through an extraordinary or an ordinary review, it will be exactly the same. So I can say that this is business as usual.

I think we need to be very careful about the process because it involves a very sensitive kind of governance for the company and its main partner airline. But it is reasonable request. It was requested and we are working on it.

What I want is to publish a Material Fact as soon as this is decided so that we can tell the market.

Victor Misuzaki:

Right. And what about the business plan?

Marcos Pinheiro:

We are also working on putting the business plan together. It needs to be approved by our Board, and as soon as it is, we will provide an update about investing in Smiles and we will communicate our strategy to everyone.

I cannot provide a firm date because this is ongoing. What I can say is that my expectation is that this will be concluded in the next month or month and a half, because we are coming to the end of the year.

André, do you have anything to add?

André Fehlauer:

Yes. Thank you for your question. About planning, as Marcos said, it is natural for the Company to see its scenario and to review some of our plans so that we can understand how this can affect us in the future.

The main idea is to always provide more, for example, for our 60 million clients. We have many partner airlines, many partner companies. How can we continue to delivering value to our stakeholders? With services in the travelers' journey, with car rentals, with flights. This is the most important thing, but we have to understand how this will take place after these important changes in the market.

Victor Mizusaki:

Great. Thank you.

Matt Fallon, Deutsche Bank:

Are you seeing any signs of a weaker macroeconomic backdrop than previously anticipated in Brazil just given the fact that consensus GDP estimates in the country were cut from 2.5% to 0.6% for the full year 2019?

Marcos Pinheiro:

Matt, thank you for your question. In fact, we have seen some effects which make our business expansions a little bit more difficult. But, as you can see in our results, we had to be much more active in employing our big data and data mining tools in order to deliver growing results still.

But your point makes a lot of sense, and we do feel not only the macro backdrop has influenced our business directly because it affects our aggregated demand curve, but we also have the situation that the civil aviation sector is going through in Brazil. There is a consolidation in the sector; specifically, GOL is having better factors, so that makes our work scope a bit more complicated.

But I do want to reaffirm that we are confident that we will continue getting clients regardless of what happened in the aviation sector or in the economy as a whole. I think we can expand and adapt to the situation that has taken place.

André Fehlauer:

I just want to add something. Obviously, forecasts for the GDP do effect us, especially in the credit card market and the travel market overall, but we have navigated these challenges in the last years very well, even in more challenging scenarios. We always try to find alternatives in how we can offer value to our clients.

We know that there are moments in which the economy is making our work more difficult and sometimes clients pay attention to that. But we are always looking at all the indicators, obviously. And I think we have a good strategy, good product, and I am sure that we can stand out from our competitors, even in a challenging market.

Matt Fallon:

Got it. Thanks. And just as a quick follow up on latter point regarding consolidation, just given the fact that Avianca Brasil is ending operations and you sort of called out the change in mix between airline ticket redemptions and non-airline redemptions, I am assuming is that a temporary phenomenon? Has that mix returned back to normal looking into the back half of 2019? Thank you for taking my questions.

Marcos Pinheiro:

Our vocation is to offer travel solutions. Our biggest competitive edge is airline tickets from our 20 partners. So obviously, we do have the desire to diversify our business and to offer more hospitality solutions as well as entertainment, but flights will definitely be a major part of our future results.

And this is one of the reasons why we started revisiting our strategic plan and why we promoted this discussion regarding our business plan. But currently, what I can reaffirm is that our competitive edge is flights.

So for Smiles to continue today to provide good results, flights will need to be predominant in our business, which does not mean that this will be the only thing in the future. But right now, this is what we have.

André Fehlauer:

Just a follow up regarding that. At the end, we do what the client wants. Now, what clients are seeking for flights, especially international flights to the U.S. and Europe, namely. So I think being competitive and having the inventory to offer the clients is essential in our strategy.

So although it is important to diversify, what clients want is clear. And if you look at any figures, their big focus has always been traveling, and dream travel, going abroad, seeing a different country. So this is what we are working on.

Matt Fallon:

Thank you for taking my questions.

Fernando Almeida, Sul Capital:

Good morning. I would like to understand what happened with accounts receivable in the last quarter. There was a variation that was quite significant. What do you think sparked that change?

Marcos Pinheiro:

Thank you for question. Well noticed. What happened was, in the previous quarter, and this has happened in other years, we had some financial partners who paid the miles that they will consume in their commercial relationship with us beforehand.

So what you saw in the 2Q was that one of our relevant partners that had one of these balances, consumed it and went back to their regular way of working, in which we file an invoice, they pay after three days and so on.

So going directly to your point, it was basically because we are returning to the natural way of running business between the Company and our partners.

Fernando Almeida:

So do you think that this will happen in the future? Because this can create a different result.

Marcos Pinheiro:

I really do not have any guidance for that. You can provide a model and we will talk about it with Investor Relations, Fernando. But usually, our negotiation model with our partners means that they have between 30 to 45 days to pay. That is the due dates for the usual contracts that we have with financial institutions, who are the main buyers of Smiles miles. And the size of that will depend on the underlying premises.

Another reason why we are not providing guidance is that the Company's business model is being revisited.

Fernando Almeida:

Okay. In terms of obtained discounts, we saw that there was a reduction of around 40% in comparison to same period last year. There was an increase in the balance that was forwarded to providers, and it was expressive, and this was much higher than the reduction in the interest rate. So why was this reduction so significant?

Marcos Pinheiro:

Thank you. There were two combined effects there. I think, one of them you captured partially, but the other one you did not mention. The most relevant provider we do this with is GOL Linhas Aéreas, and that is what provides for these results.

So, during this period, one of the effects was, in the past, there were transactions that we had with GOL for previous purchases, charging a 132% of the CDI spread, as I had already explained in previous quarters.

Obviously, you can notice that the financial situation at GOL has become more positive, so these conditions have been very healthy. Vis-à-vis, during the last transaction that GOL submitted to Smiles, to our independent committee and the Board, the spread was expressively lower. So, it went from 132% of the CDI to 115%.

If that were not enough, CDI went from 16% to 7%. So, there was a reduced interest rate and a reduced spread that we charged from GOL since this partner's now having a better financial situation. These are the two effects that you can reconcile if you look at the last quarter's results.

Fernando Almeida:

But the rate that was agreed upon in 2018 was 8.97%, and the one that you are using now is 1.89%.

Marcos Pinheiro:

Yes, there was a big reduction. Fernando, I will tell you how you can do this calculation later. The CDI and the spread were reduced. These were the two combined effects, and then you need to reconcile all the contracts signed and remember that these contracts are set in different stages. But if you read all the ITRs published by the Company, this is very transparent.

Fernando Almeida:

OK. Thank you.

Lucas Barbosa, Morgan Stanley:

Good morning. Thank you for taking my question, and congratulations on your results. My question is about the direct redemption margin. In the 2Q, you provided a very good margin, despite the challenging scenario you had at the airline industry. Do you see any delays between GOL's expansion and the potential impact that you will have in rates? We know that there is a distance between reservations and flights. So this increased yield, will it have any effect in the 3Q? Obviously, there is another side, the pricing efforts that GOL has made will change this as well. Thank you.

Marcos Pinheiro:

Lucas, thank you for your question. That is a great question, by the way. It really has become more difficult to deal with this situation. What I can tell you is that a group that works with pricing and CRM has increased the number of hours they work to sell tickets expressively.

The effect you are asking about for a possible delay, I do not think that is going to take place, but I do need to be very transparent in saying that we cannot make sure that this margin will remain the same.

You were very direct in saying that we have a new situation now in the airline sector with regard to GOL and their yields, and we use all the tools to try to offset this effect.

Our commitment that has been reinforced by André, and I will say it once again, is to continue engaging with clients. We are going to do what we can to get more clients, to retain older clients, to promote more trips to our user base, and to try to keep the loyalty wheel turning in a positive way. What we can say right now is this.

André Fehlauer:

Lucas, just a follow on to Marcos' answer. We have some tools. We know that it is easier to redeem miles here, it is easier to manage higher clients experience here. The point is the negotiation you have with your partners, how many miles were sold and consumed at the end and, of course, your cost for the inputs you are redeeming. And, of course, all the pricing intelligence that we have in offering our clients what makes the most sense to them.

So we try to extract the best of all of these factors. This is what we do with our team, to try to manage all of these points. So I do not think I have a very clear answer. Of course, when something changes, we need to be diligent and to change the mix as a whole. But it is a challenge, especially in this quarter as the pricing team has done excellent work and they have been helping us very much, and they will continue to work very hard.

This is something that we have been doing for five, six years. And we have projects for this year and next year to make this even more sophisticated, our pricing strategy, not only for airlines but to all the redeeming partners.

So the idea is to look at the customer's experience, the promotional platform, that is very important for financial partners and for our products. It is very delicate tune that we have to make in order to make it work.

Lucas Barbosa:

Right. Thank you for your answer. Just a follow up: can you tell us about the mix of flights in promo? Did the load factor change? Can you say anything about the mix?

Marcos Pinheiro:

I am sorry, we cannot say anything. You can imagine it, but I really cannot give you any information about the ticket mix. This is something that we do not disclose.

Lucas Barbosa:

No problem. Thank you very much.

Victor Misuzaki, Bradesco BBI:

I have two questions. First, regarding the evolution of the gross billings, there has been a strong level of growth. Can you tell us a bit about how much Argentina contributed to

this growth? As you mentioned in your presentation, you already started launching new products there, so that is why I am asking.

And the second question is, can you tell us a bit about the average price for banks? Can you shed any light on that? Thank you.

André Fehlauer:

Victor, thank you for question. With Argentina, we have been growing significantly, but it is still a small operation in comparison to what we have in Brazil. So we have important and positive expectations for Argentina, but this is a business that is still maturing. We started this year, we already have some results, but it is still small in comparison to Brazil. And we do not have any information on Argentina only.

About our work with banks, we have grown a lot in our gross billings. As I said in my presentation, this plays an important role because there are some of the main financial partners we have. We do not disclose the average price because we have been trying, and this has worked very well, to keep banks engaged.

When a bank needs to decide where they are going to focus, that is, which loyalty program they are going to direct their miles to, there is always negotiations. We want them to see more value in Smiles.

I will give you some examples. Besides the promotional activities that we have, we have Smiles exclusive products. For example, Viaje Fácil, where clients can book a ticket without any miles and then they have 60 days to pay. This is very good for bank clients because they can define their ticket before sending the miles, so miles are accrued sometimes in the bank's credit card. So, this is insured and then the miles are brought over. Even our booking system with GOL, which allows us to plan for that, is important.

Another Smiles' exclusive product is the family account. You can have six accounts in one, so all of their accrual will be in a single account. That makes it much easier for people to use their miles.

So, what we have been able to do with banks is to have these competitive edges. And this is done through product and services, and not only bonuses or the number of points. And we have been successful with this strategy.

Victor Misuzaki:

Okay. But considering the competition, considering the 1Q results and now, did you have to provide more bonuses in order to defend your market? And did that lead to a possible dilution of the prices? Or is it stable?

Marcos Pinheiro:

Due to a strategic issue, we stopped disclosing some of the factors that allowed you to calculate the average price. I am flattered by your question, but I will respectfully have to stand firm in saying that we are not going to disclose our commercial strategy.

But in order to help you with your work, I would just like to highlight something that is in our logic. Air flights are more expensive. And if what we sell is air flights, then naturally a part of these costs will be passed on.

So our goal is clear: we want to continue to have a society that generates profits. So we are going to have several discussions. We are always open to talking with important partners. But the business needs to grow, and it needs to be sustainable.

You already know my cost, it is going up, and there is no way of absorbing it by reducing administrative expenses. We only have 120 employees in Brazil and some more in Argentina. The point is, the price will go up and the Company will continue to grow.

Victor Mizusaki:

Thank you.

Operator:

The questions and answer session is now closed. We would like to give the floor to André Fehlauer for his final remarks.

André Fehlauer:

Thank you all for listening to this conference call. And I would also like to thank the Smiles team, which has done fantastic work this quarter and also the last ones. We were able to overcome several of our record figures in the last quarter.

We will talk to you next quarter. Thank you and have a good day.

Operator:

This concludes Smiles' conference call. Thank you for listening and have a good day.



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