

BCP Research: Gol (GOLLBZ: /B/B+) - Landmark Codeshare Partnership with AA - Maintain 'Positive-Swap' on Convert 24s

Published: February 4th 2020

Summary: Today, Brazilian airline, Gol announced its codeshare agreement with American Airlines (AA). The move is the latest development in US airlines' shuffle for LatAm feeder networks and places Gol at the top of the leaderboard as a partner in U.S./LatAm's largest airline partnership by flights, with 88 domestic and 16 international flight destinations, and 179 international destinations through its codeshare agreements. As stated in our previous note (9/27/19), AA offers an ideal match for Gol, adding thirty (30) U.S. destinations from Gol's São Paulo, Rio de Janeiro, Brasília and Fortaleza routes to the existing two (2) to Miami and Orlando. In contrast, Gol's previous partner, Delta, offered only three (3) daily flights to the U.S. Now, with Gol and AA partnered, a Delta and LATAM partnership seems more likely, and may prove a better fit.

This most recent development in the Gol story is a positive one, backed by robust fundamental performance, and numerous macroeconomic tailwinds, including easing cost pressures, favorable f/x and oil movement and BZ airline consolidation. Guidance provided by the company implies 4Q19 results will be strong, in line with seasonality, but also reflective of its improved profitability and rationalization of its balance sheet. Assuming midpoint cash outflow (US\$235 – 352 mm) and FY19 Pro-Forma EBITDA of US\$1,057 mm (based on Gol guidance 1/8/2020), we estimate 2.9x pro-forma net leverage (incl. operating leases) for FY19. Based on ongoing fundamental strength, we anticipate this multiple will continue to contract, exemplifying the company's sound liability management strategy.

We reiterate our 'Positive – Swap' rating on the convertible 3.75% 24s, based on attractive volatility spread (50% 100D vs. 24% IVOL).

			Amt Out (US\$ MM)	M/SP/F	Mid Price	Mid YTW
GOLLBZ	8.88%	1/24/2022	78	-/ B/ B+	103.0	7.21%
GOLLBZ	3.75%	7/15/2024	650	-/ B/ B+	101.9	6.55%
GOLLBZ	7.00%	1/31/2025	154	B2/ -/ B+	100.8	8.68%
GOLLBZ	8.75%	Perp	78	-/ B/ B+	103.0	7.21%

	Amt Out (US\$ MM)	Mid Price	Mid YTW	Implied Vol	Cheapness (par)	Delta (par)	Conv. Price	GOL US Price	Recommendation
GOLLBZ 3.75% 7/16/2024	345	109.7	1.49%	24.4%	12.4%	81.7 %	20.25	\$16.62	Positive - Swap

FY19 Pro-Forma Results:

Gol's recent as of 1/8/2020 guidance shows EBITDA margins of 37-39% for 4Q19 (3Q19: 31%, 4Q18: 36%), in line with its seasonally high performance and improved profitability. Assuming midpoint cash outflow (US\$235 – 352 mm) as a result of the recent Smiles/Gol exchange (see 12/18/2019 note for details), and FY19 Pro-Forma EBITDA of US\$1,057 mm, we estimate 2.9x pro-forma net leverage in FY19. We anticipate this multiple will continue to contract based on Gol's ongoing fundamental strength, improved operating synergies post the structural reorganization of Smiles, and sound liability management strategy.

FY19 Pro-Forma Cash Flow (US\$MM)	2019
Revenue	3,473
EBITDA	1,057
<i>EBITDA margin</i>	30%
(-) Capex	(177)
(-) Interest Paid *	(131)
(-) Cash Lease *	(334)
(-) Cash Taxes Paid **	(24)
Pro-forma FCF (Before WK and taxes)	390

*Average 2017-2018. Cash lease includes Aircraft Rent (IS) and Lease Payments (CF) to reflect impact of IFRS 16

** Based on revenue, pre-tax margin and effective income tax rate guidance. Assumes 50% cash tax payment based on historical tax expense and income tax paid

FY19 Pro-Forma Leverage	US\$MM
FY19 Pro-Forma EBITDA *	1,057
3Q19 Gross Debt	3,485
Cash **	441
Net Debt	3,044
Pro Forma Gross Leverage (Gross Debt (incl op leases) / FY19 Pro-Forma EBITDA)	3.3x
Pro Forma Net Leverage (Net Debt (incl op leases) / FY19 Pro Forma EBITDA)	2.9x

* Based on Gol Guidance as of 1/8/2019

** Assumes midpoint cash payment on Gol redeemable shares

Convertible Valuation:

CONVERTIBLE BOND	GOL EQUITY FINANCE SA
Country of Risk	Brazil
Industry Group	Airlines
Ticker	GOLLBZ
Coupon	3.75%
Maturity	7/15/2024
Amount Out (mm)	425.0
Rank	Sr Unsecured
Mid Price	109.7c
Mid YTM	1.49%
Share Conversion Price	20.25
Parity	82.5
Premium	27.8

Convertible Valuation (cont'd):

EQUITY	GOL US
Share Price as of 2/4/2020 (USD)	16.62
Current Market Cap (US\$ bn)	3.0
Net Leverage (Net Debt / LTM EBITDA)	2.7x
BCP Credit Spread Estimate	455
Realized Share Volatility (100D)	49.7%
Implied Volatility	24.4%
Fair Value (vs 100D realized vol)	125.7
(Rich)/Cheap %	12.4%
Delta	81.7%
Bond Floor	91.1
Implied Share Volatility (ATM 30D listed calls)	51.9%

* Source: Equity information sourced from Bloomberg. Convertible pricing as of February 4th 2020.

We reiterate our 'Positive – Swap' rating on the convertible 3.75% 24s, based on attractive volatility spread (50% 100D vs. 24% IVOL).

Megan E. McDonald
Investment Research Analyst
BCP Securities, LLC

289 Greenwich Avenue, Ste 4
Greenwich, CT 06830
+1-203-629-2185 ext. 312
mmcdonald@bcpsecurities.com
www.bcpsecurities.com

Matias Castagnino, CFA
BCP Securities, LLC

Paseo de la Castellana, 91
28064 Madrid, Spain
+34 91 310 6980
mcastagnino@bcpsecurities.com
www.bcpsecurities.com

[Want to read more of BCP Securities' Convertible Research? Click Here](#)

**DISCLOSURE APPENDIX
REGULATION AC - ANALYST CERTIFICATION**

We, Megan McDonald and Matias Castagnino, certify that all of the views expressed in this report accurately reflect our personal views about the subject securities and issuers. We also certify that no part of our compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by us in this report.

COMPANY SPECIFIC DISCLOSURES

This report may not be independent of BCP's propriety interests. BCP does business, and seeks to do business, with companies covered in BCP research. As a result, investors should be aware that BCP may have a conflict of interest that could affect the objectivity of this report. Further, BCP may trade the securities (or related derivatives) that are the subject of this research report for its own account and for certain customers, and may from time to time maintain long or short positions in the securities (or in related derivatives) of the companies mentioned in this report. Such financial and trading interests may be contrary to any recommendation in the report.

BCP's salespeople, traders and other professionals may provide oral or written market commentary or trading strategies to our clients and our proprietary trading desks that reflect opinions that are contrary to the opinions expressed in this research.

MEANINGS OF RATINGS

"Market Outperform" – The bond's total return is expected to exceed the total return of the J.P. Morgan Corporate Emerging Markets Bond Index series ("CEMBI") Broad Diversified High-Yield Index over the next 3 – 6 months.

"Market Perform" – The bond's total return is expected to be in line with the total return of the CEMBI Broad Diversified High-Yield Index over the next 3 – 6 months.

"Market Underperform" – The bond's total return is expected to be below the total return of the CEMBI Broad Diversified High-Yield Index over the next 3 – 6 months.

"Not Rated" or no comment – Currently, the analyst does not have adequate conviction about the bond's total return relative to the CEMBI Broad Diversified High-Yield Index over the next 3 – 6 months.

GENERAL RESEARCH DISCLOSURES AND DISCLAIMERS

This report is intended only for institutional investors and should not be redistributed to retail investors. BCP research is not a solicitation or offer to buy or sell any security or financial instrument or to participate in any trading strategy. The products mentioned in this report may not be eligible for sale in some states or countries.

The analysts principally responsible for the preparation of BCP research receive compensation based upon various factors, including quality, accuracy and value of research, firm profitability or revenues (including overall investment banking revenues), client feedback and competitive factors. The compensation of BCP analysts is not linked to specific investment banking or capital markets transactions by BCP. Analysts employed by non-U.S. affiliates may not be registered with FINRA, may not be associated persons of BCP, and may not be subject to FINRA regulations regarding research related activities.

BCP research is based on public information. BCP makes every effort to use reliable, comprehensive information, but makes no representation that the information is accurate or complete. Facts and views presented in BCP research have not been reviewed by, and may not reflect information known to, professionals in other BCP business areas, including investment banking personnel. BCP analysts may interact with sales and trading desk personnel in connection with their research, including to ascertain pricing and liquidity in the fixed income markets.

This report has been prepared independently of any issuer of securities mentioned herein and not in connection with any proposed offering of securities or as agent of any issuer of any securities. BCP has no authority to make any representation or warranty on behalf of the issuers. BCP policy prohibits research personnel from disclosing a recommendation, investment rating, or investment thesis for review by an issuer prior to the publication of a research report containing such rating, recommendation or investment thesis.

BCP may update its research reports and ratings as it deems appropriate, but has no obligation to do so. BCP has no obligation to inform clients of any changes in facts, assumptions, opinions, estimates, or ratings. Certain outstanding reports may contain discussions and/or investment options relating to securities, financial instruments and/or issuers that are no longer current. Neither BCP nor any officer or employee of BCP accepts any liability whatsoever for any direct, indirect or consequential damages or losses arising from any use of this report or its contents.

BCP research and ratings should not be used or relied upon as investment advice. BCP research does not provide individually tailored investment advice. BCP research has been prepared without regard to the circumstances and objectives of those who receive it. BCP recommends that investors independently evaluate particular investments and strategies, and encourages investors to seek the advice of a financial adviser. Investors should consider this report as only a single factor in making their investment decisions. The appropriateness of an investment or strategy will depend on an investor's circumstances and objectives. The securities, instruments, or strategies discussed in BCP research may not be suitable for all investors, and certain investors may not be eligible to purchase or participate in some or all of them. Securities discussed in this report may be rated below investment grade and should therefore only be considered for inclusion in accounts qualified for speculative investment.

The value of and income from your investments may vary because of changes in interest rates, foreign exchange rates, default rates, prepayment rates, prices, market indexes, operational or financial conditions of companies or other factors. Past performance is not necessarily a guide to future performance. Estimates of future performance are based on assumptions that may not be realized. Investors may experience a loss of their original capital investment in such securities.

International investing entails greater risk, as well as greater potential rewards compared to U.S. investing. These risks include political and economic uncertainties of foreign countries as well as the risk of currency fluctuations. These risks are magnified in countries with emerging markets, since these countries may have relatively unstable governments and less established markets and economies.

Bonds are subject to interest rate risk. When interest rates rise, bond prices fall; generally the longer a bond's maturity, the more sensitive it is to this risk. Bonds may also be subject to call risk, which is the risk that the issuer will redeem the debt at its option, fully or partially, before the scheduled maturity date. The market value of debt instruments may fluctuate, and proceeds from sales prior to maturity may be more or less than the amount originally invested or the maturity value due to changes in market conditions or changes in the credit quality of the issuer. Bonds are subject to the credit risk of the issuer. This is the risk that the issuer might be unable to make interest and/or principal payments on a timely basis. Bonds are also subject to reinvestment risk, which is the risk that principal and/or interest payments from a given investment may be reinvested at a lower interest rate. Bonds rated below investment grade may have speculative characteristics and present significant risks beyond those of other securities, including greater credit risk and price volatility in the secondary market.

INTERNATIONAL DISCLOSURES

Singapore: This report is distributed in Singapore by BCP Securities Asia Pte Ltd to accredited investors, expert investors or institutional investors only (as defined in the applicable Singapore laws and regulations and is not intended to be distributed directly or indirectly to any other class of person). Recipients of this report in Singapore are to contact BCP Securities Asia Pte Ltd in respect of any matters arising from, or in connection with, this report. BCP Securities Asia Pte Ltd is registered with the Accounting and Corporate Regulatory Authority.

Spain: The report is distributed in Spain by BCP European Agencia de Valores, S.A., supervised by the Spanish Securities Markets Commission (CNMV), and is written and distributed in accordance with rules of conduct for financial research under Spanish regulations. This report is only intended for persons who are Eligible Counterparties or Professional Clients within the meaning of Article 78bis and Article 78ter of the Spanish Securities Market Act. It is not intended to be distributed or passed on, directly or indirectly, to any other class of persons. There is no obligation to register or file any report and any supplemental documentation or information with the CNMV. Neither verification nor authorization or compliance revision by the CNMV regarding this document and related documentation or information needs to be fulfilled in accordance with the Spanish Securities Market Act.

Brazil: This report is distributed in Brazil by BCP Securities Brazil (RJ) in accordance with applicable regulations. No approval is required for publication or distribution of this report in Brazil. The views expressed above accurately reflect personal views of the authors about the subject companies and their securities. The compensation of the equity research analyst(s) is indirectly affected by revenues deriving from the business and financial transactions of BCP. Where a Brazil based analyst has taken part in the preparation of this research report, the Brazil based analyst whose name appears first assumes primary responsibility for its content from a Brazilian regulatory perspective and for its compliance with CVM Instruction 483.

COPYRIGHT AND USER AGREEMENT

Copyright 2020 BCP Securities, LLC. All rights reserved. This research report is prepared for the use of BCP clients and may not be redistributed, retransmitted or disclosed, in whole or in part, or in any form or manner, without the express written consent of BCP. Any unauthorized use or disclosure is prohibited. Receipt and review of this research report constitutes your agreement not to redistribute, retransmit, or disclose to others the contents, opinions, conclusions, or information contained in this report (including any investment recommendations, estimates or price targets) without first obtaining expressed permission from an authorized officer of BCP.