GOL Linhas Aereas Inteligentes S.A. (NYSE: GOL)

Group 4: Sarah Byrne, Greg Green, Ryan Rabe, Anish Singh

RECOMMENDATION		
BUY	**HOLD**	SELL

Current Price	$24.35
Target Price Range	**$27.50**

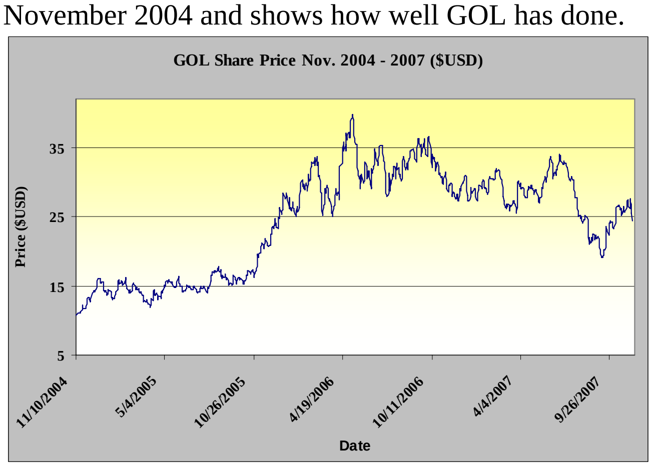
Investment Thesis

- Based on a relative TEV/EBITDAR valuation, we feel GOL is hold and is undervalued by 11%
- 5.9% passenger volume increase in South America leading to a 20% revenue growth in 08 and 09
- GOL has had a significant increase in operating expenses from fuel prices and acquisition, lowering operating margin to 1.24% in 07
- We are forecasting exchange rates to become more favorable in 2009 reaching our target of 2 BRL/USD

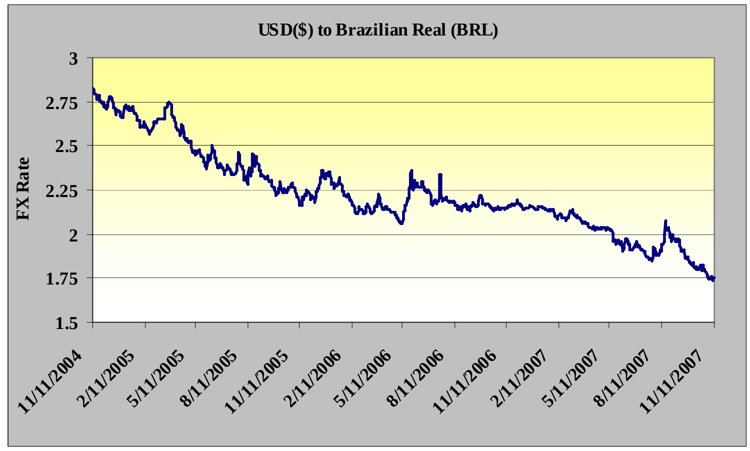
Stock Information	
Market Capitalization	$4.93 billion
Shares Outstanding	202.3 million
TEV	$5.39 billion
P/E (08)	26.76
Beta	.88
TEV/EBITDAR (08)	11.80
ROE	7.44%
ROA	0.69%

Total Return Since 2004

The following graph shows GOL's share price since November 2004 and shows how well GOL has done.



However, because of the extremely weak dollar, the real return has been significantly less than the 129% the paper return would suggest. In November 2004, 1 USD was worth 2.86 Brazilian Real (BRL), now 1 USD is worth only 1.74 BRL. With this factored in, the real return over the past 3 years has been 28%. With the current state of U.S. dollar, we feel that GOL is a buying opportunity as our outlook is that the Fed will stop decreasing rates, causing the U.S. exchange rate to increase to around 2 BRL/USD. Below is a graph of the exchange rate since November of 2004.



Analysts Expectations

Immediately prior to and following GOL's 3Q earnings call and release on November 7, 2007, multiple analysts assumed a neutral or downgraded opinion towards GOL. Santander Investments downgraded GOL from a "buy" to "hold." Results were in-line with estimates by both Merrill Lynch and Bear Stearns. And Morgan Stanley was the only exception, implying a more neutral opinion though expecting GOL's margins and yield to increase by the end of FY2008.

Prior to the release, Avondale Partners estimated 3Q EPS to be -0.04, 4Q EPS to be -0.24 and FY2007 to be -0.06. After the release, Avondale expressed further concern by issuing an analyst report emphasizing their "market underperform" rating due to very low margins. Avondale went so far as to reduce its 9-month target price to 40% of GOL's current price, or approximately $9.00/share.[1]

	Yahoo	Reuters
2007Q4 Rev	873M	921M
2007 Rev	2.87B	2.85B
2008 Rev	4.13B	4.0B
2007Q4 EPS	$ 0.35	$ 0.49
2007 EPS	$ 0.91	$ 0.95
2008 EPS	$ 1.92	$ 1.90

[1] "GOL – A Quick Note Highlighting Our Guidance Concerns." Bob McAdoo, Avondale Partners LLC. 9 November 2007.

Industry opinions were very similar in that most analysts consider the airline industry to still be relatively weak and risky. Bear Stearns, Morgan Stanley and Avondale all express concern with rising jet fuel prices and the resulting effects on GOL's margins. Bear Stearns and Morgan Stanley also believe that industry capacity is growing at such a rate that supply will soon surpass demand, lowering prices. Merrill Lynch's belief is that the demand for the travel industry is slowly recovering and several analysts expressed concern regarding future, unexpected government regulations in the industry.

Relative Valuation

Due to the fact that GOL has negative cash flow, it obviously doesn't make sense to do a DCF valuation. Attached on page 3 is our pro-forma income statement, but following is a comparison of GOL's closest competitors. Margins for the competition vary with JetBlue with having the lowest net income margin at 3% and GOL having the highest gross margin at 30%. The rest of the margins are as indicated below.

Data from MRQ	GOL	RYAAY	LUV	JBLU	WJA.TO
Net Income Margin	3.50%	9%	6.50%	3%	11.70%
Gross Margin	31%	18.60%	10.40%	10.30%	21.50%

GOL's gross margins are the highest among the competitors, but because of their rising costs like jet fuel, their net income margin is significantly lower than the competitors. Other valuation metrics we used to compare these companies were price/sales and price/book.

Data from MRQ	GOL	RYAAY	LUV	JBLU	WJA.TO
Price/Sales	1.40	3.77	1.01	0.46	1.29
Price/Book	2.60	3.46	1.55	1.24	3.11

Based on these valuation metrics, we can see that GOL is in the middle of the road for Price/Sales and Price/Book. These metrics aren't as valuable to us when determining the value of the company, but they do provide useful insight when comparing to the industry. It shows that investors are paying significantly more for revenue/share for RyanAir than JetBlue.

Data from MRQ, $USD MM	GOL	RYAAY	LUV	JBLU	WJA.TO	Avg.
EV	5396	12550	9733	3440	3115	6847
2008 Revenue	3102	1264	2558	765	476	1633
2008 EBITDAR	458	777	1187	151	152	545
EBITDAR Margin	15%	61%	46%	20%	32%	35%
2008 Net Income	121	201	57	23	12	83
Net Income Margin	4%	16%	2%	3%	3%	6%
Projected EPS Growth	48%	16%	15%	25%	20%	25%
LTM Dividend Yield	2.30%	-	0.15%	-	-	1.23%
P/E 2007	33	19	17	33	14	23
P/E 2008	22	19	21	50	14	25
PEG Ratio	0.69	1.19	1.18	1.35	0.71	1.02
EV/EBITDAR	11.8	16.2	8.2	22.8	20.5	15.9

Acquisition of VARIG

During GOL's formation, VARIG, the national airline of Brazil, was suffering from a number of financial hardships making it difficult to compete in the Brazilian airline industry. VARIG declared bankruptcy, after which several large airline companies (including GOL) began a bidding war for the remains of VARIG. In April 2007, GOL acquired these remains including 14 aircraft and many intellectual property rights. This purchase was made for USD$275M though the inclusion of $45M in debt results in a total cost of nearly $320M. It is GOL's intention to operate VARIG as a separate entity under the GOL parent company while maintaining several unique VARIG services in order to maintain a customer base.[2] VARIG will, however, keep GOL's low-cost, low-fare business model. "The combined strength of GOL and VARIG will establish a Brazilian airline group with a growing passenger base of over 20 million annually, capable of competing on the South American and world stages against other large international airlines. GOL and VARIG together, through higher efficiencies generated to the market and consumers, will be ready to assume leadership of domestic and international flights among Brazilian carriers. The combination of these two companies will provide the ability to increase the number of seats offered at low fares and will stimulate growth in air travel."[3]

With regards to its comparables, GOL has a FY08 forecasted revenue of $3,101(mil.) which is higher than the competitor average of $1,632 while net income continues to remain stronger than the field of competition at $121m (average net income: $83). Income margins are in line with competitors in the range of 2-4%, however gross margin is much higher at 31% compared to the high teens to low twenties of competitors. Margin values are effected primarily because rise in operating costs especially fuel costs. GOL is firmly ahead of comps in forecasted EPS growth at 47.54% with Jet Blue following at 24.86%.

---

[2] "GOL – A Quick Note Highlighting Our Guidance Concerns." Bob McAdoo, Avondale Partners LLC. 9 November 2007.
[3] "GOL Announces Acquisition of VARIG." http://peanuts.aero/low_cost_airline_news/index.php?option=com_content&task=view&id=2670&Itemid=59. March 29, 2007.

GOL Earnings Forecast In Millions of USD	FY 2004	FY 2005	FY 2006	Q1 2007	Q2 2007	Q3 2007E	Q4 2007E	FY 2007E	FY 2008E	FY 2009E	FY 2010E
Total Net Revenue	717.0	1,140.6	1,776.6	507.9	596.6	746.4	695.2	2,521.5	3,101.7	3,500.6	3,924.9
Revenue Growth	40.0%	36.1%	42.4%	20.7%	36.4%	20.4%	20.2%	24.0%	21.8%	19.0%	15.0%
Operating Income	210.7	265.5	327.8	61.0	(48.4)	17.6	(1.2)	32.8	85.3	201.3	392.5
Operating Margin	29.4%	23.3%	18.4%	12.0%	-8.1%	2.4%	-0.1%	1.3%	2.7%	5.8%	10.0%
Net Income	140.7	219.3	266.0	56.9	(18.3)	26.1	24.7	80.9	120.6	207.3	347.4
Income Margin	19.6%	19.2%	15.0%	11.2%	-3.1%	3.5%	2.0%	3.2%	3.9%	5.9%	8.9%
Earnings Per Share	0.78	1.13	1.36	0.29	(0.09)	0.13	0.12	0.40	0.60	1.02	1.72
EPS Growth	99.1%	24.4%	9.4%	-35.9%	NA	-77.3%	-74.1%	-74.2%	47.5%	81.1%	71.9%
EBITDAR	290.0	383.4	496.9	121.4	37.4	110.7	150.86	356.0	457.5	603.8	824.2
EBITDAR Margin	40.4%	33.6%	28.0%	23.9%	6.3%	14.8%	12.4%	14.1%	14.8%	17.3%	21.0%
BRL/USD Exchange Rate	2.735	2.340	2.140	2.050	1.930	1.747	1.750	1.869	1.850	1.950	2.000

Pro Forma Assumptions

- Boeing estimates that South American air traffic will increase 5.9% per year through 2010.[4] We feel that GOL is well positioned to take advantage of this growth due to being the only low cost carrier in Brazil. We feel the company can maintain a 20% growth rate into the future.
- GOL's operating expenses have risen significantly in 2007 due to rising fuel prices and from the acquisition of VRG. GOL's operating margin has decreased from 18.4% in 2006 to an estimated 1.2% in 2007. We felt that fuel prices will continue to remain high in the future and have forecasted GOL's operating margin to improve slightly from 1.2% to 5.9% in 2010.
- We feel that depreciation of the US dollar against the Real will reverse in 2008 as the US economy recovers from the current credit problems. In order to remain conservative we forecasted only slight appreciation of the BRL/USD exchange rate. We felt that it will appreciate from 1.74 currently to 2.00 BRL/USD in 2010.

EV/EBITDAR Relative Valuation

EV/EBITDAR Relative Value In USD	
2008 EBITDAR	457.5
Competitive Ratio	15.88
Implied EV	7,267.1
Less Debt	603.9
Plus Cash	160.4
Equity Value	6,823.7
Shares Outstanding	202.32
Implied Share Price	33.73

Sensitivity Analysis

- We felt that an industry EV/EBITDAR ratio of 15.9 was a little high and performed a sensitivity analysis to show how GOL's value would vary depending on different industry multiples.
- From our sensitivity analysis we found a range of prices varying from $19.50 to $41.00 per share. We felt the relevant range of EV/EBITDAR multiples was 14 – 14.5 and that gave us a target price of 27.50.

EV/EBITDAR Sensitivity Analysis

EBITDAR Multiple	2008 EBITDAR 350.0	400.0	457.5	500.0	550.0
12.5	19.43	22.52	26.07	28.70	31.79
13.0	20.30	23.51	27.21	29.94	33.15
13.5	21.16	24.50	28.34	31.17	34.51
14.0	22.03	25.49	29.47	32.41	35.87
14.5	22.89	26.48	30.60	33.64	37.23
15.0	23.76	27.46	31.73	34.88	38.59
15.5	24.62	28.45	32.86	36.11	39.94
15.9	25.49	29.24	33.73	37.1	41.03

Conclusion

Due to GOL having a negative free cash flow, it was necessary to use other types of relative valuation. Based on our EV/EBITDAR valuation, we feel GOL is undervalued. However, after factoring in rising gas prices and high cost of acquisition and transition costs for VRG, we feel that GOL would be a hold if we owned it for the portfolio.

[4] GOL 2006 10-K