Gol Intelligent Airlines Inc.
Form 20-F
April 28, 2014

As filed with the Securities and Exchange Commission on April 28, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

¨ **REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934**

OR

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2013

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

OR

¨ **SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number 001-32221

Gol Linhas Aéreas Inteligentes S.A.

(Exact name of Registrant as specified in its charter)

Gol Intelligent Airlines Inc.

(Translation of Registrant’s name into English)

The Federative Republic of Brazil

(Jurisdiction of incorporation or organization)
Edmar Prado Lopes Neto
+55 11 5098-7872
Fax: +55 11 5098-2341
E-mail: ri@golnaweb.com.br
Praça Comandante Linneu Gomes, S/N Portaria 3,
Jardim Aeroporto
04626-020 São Paulo, São Paulo
Federative Republic of Brazil
(+55 11 2128-4700)

(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)

Securities registered or to be registered pursuant to Section 12(b) of the Act.

Title of each class:	**Name of each exchange on which registered:**
Preferred Shares, without par value	**New York Stock Exchange***
American Depositary Shares (as evidenced by American Depositary Receipts), each representing one share of Preferred Stock	**New York Stock Exchange**

* Not for trading purposes, but only in connection with the trading on the New York Stock Exchange of American Depositary Shares representing those preferred shares.

Securities registered or to be registered pursuant to Section 12(g) of the Act:
None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:
7.50% Senior Notes Due 2017

The number of outstanding shares of each class of stock of Gol Linhas Aéreas Inteligentes S.A. as of December 31, 2013:

143.858.204	**Shares of Common Stock**
135.003.122	**Shares of Preferred Stock**

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

If this is an annual or transition report, indicate by check mark if the Registrant is not required to file pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes ¨ No x

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files). Yes ¨ No ¨

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated Filer ¨	Accelerated Filer x	Non-accelerated Filer ¨

Indicate by check mark which basis of accounting the Registrant has used to prepare the financial statements included in this filing:

U.S. GAAP ¨	International Financial Reporting Standards as issued by the International Accounting Standards Board x	Other ¨

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the Registrant has elected to follow.

Item 17 ¨ Item 18 ¨

If this is an annual report, indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

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Presentation of Financial and Other Data

The consolidated financial statements included in this annual report have been prepared in accordance with International Financial Reporting Standards (IFRS), issued by the International Accounting Standards Board (IASB), in *reais.*

We have translated some of the *real* amounts contained in this annual report into U.S. dollars. The rate used to translate such amounts in respect of the year ended December 31, 2013 was R$2.343 to US$1.00, which was the commercial rate for the purchase of U.S. dollars in effect on December 31, 2013, as reported by the Central Bank. The U.S. dollar equivalent information presented in this annual report is provided solely for the convenience of investors and should not be construed as implying that the *real* amounts represent, or could have been or could be converted into, U.S. dollars at the above rate. See "Exchange Rates" for more detailed information regarding the Brazilian foreign exchange system and historical data on the exchange rate of the *real* against the U.S. dollar.

In this annual report, we use the terms "the Registrant" to refer to Gol Linhas Aéreas Inteligentes S.A., and "Gol", "Company", "we," "us" and "our" to refer to the Registrant and its consolidated subsidiaries together, except where the context requires otherwise. The term VRG refers to VRG Linhas Aéreas S.A., a wholly owned subsidiary of the Registrant. References to "preferred shares" and "ADSs" refer to non-voting preferred shares of the Registrant and American depositary shares representing those preferred shares, respectively, except where the context requires otherwise.

The operating results of Webjet Linhas Aéreas S.A., or Webjet, are consolidated in our financial statements as from October 3, 2011. All information in this annual report reflects the acquisition of Webjet, unless otherwise indicated.

In 2013, we segregated the Smiles loyalty program activities into Smiles S.A. In May 2013, Smiles concluded its approximately R$1.1 billion initial public offering, which allowed for the creation of a fully dedicated management team that will pursue all business opportunities from the growth of this market in Brazil. Smiles' results are reported in a consolidated basis. For purposes of reconciliation with the income (loss), assets and liabilities, as well as for purposes of equity method of accounting and for consolidation purposes, we eliminated entries and consolidation adjustments to conform our accounting practices related to Smiles' revenues.

The phrase "Brazilian government" refers to the federal government of the Federative Republic of Brazil, and the term "Central Bank" refers to the Banco Central do Brasil, or the Central Bank. The term "Brazil" refers to the Federative Republic of Brazil. The terms "U.S. dollar" and "U.S. dollars" and the symbol "US$" refer to the legal currency of the United States. The terms "*real*" and "*reais*" and the symbol "R$" refer to the legal currency of Brazil. "IFRS" refers to the international financial reporting standards issued by the International Accounting Standards Board, or IASB. We make statements in this annual report about our competitive position and market share in, and the market size of, the Brazilian and international airline industry. We have made these statements on the basis of statistics and other information from third party sources, governmental agencies or industry or general publications that we believe are reliable. Although we have no reason to believe any of this information or these reports are inaccurate in any material respect, we have not verified the competitive position, market share and market size or market growth data provided by third parties or by industry or general publications. All industry and market data contained in this annual report is based upon the latest publicly available information as of the date of this annual report.

Certain figures included in this annual report have been rounded. Accordingly, figures shown as totals in certain tables may not be an arithmetic sum of the figures that precede them.

This annual report contains terms relating to operating performance in the airline industry that are defined as follows:

- "Aircraft utilization" represents the average number of block-hours operated per day per aircraft for the total aircraft fleet.

- "Available seat kilometers" or "ASK" represents the aircraft seating capacity multiplied by the number of kilometers flown.

- “Average stage length” represents the average number of kilometers flown per flight.

- “Block-hours” refers to the elapsed time between an aircraft’s leaving an airport gate and arriving at an airport gate.

- “Breakeven load factor” is the passenger load factor that will result in passenger revenues being equal to operating expenses.

- “Load factor” represents the percentage of aircraft seating capacity that is actually utilized (calculated by dividing revenue passenger kilometers by available seat kilometers).

- “Operating expense per available seat kilometer” or “CASK” represents operating expenses divided by available seat kilometers.

- “Operating expense excluding fuel expense per available seat kilometer” or “CASK - ex fuel” represents operating expenses less fuel expense divided by available seat kilometers.

- “Operating revenue per available seat kilometer” or “RASK” represents operating revenues divided by available seat kilometers.

- “Passenger revenue per available seat kilometer” or “PRASK” represents passenger revenue divided by available seat kilometers.

- “Revenue passengers” represents the total number of paying passengers flown on all flight segments.

- “Revenue passenger kilometers” or “RPK” represents the numbers of kilometers flown by revenue passengers.

- “Yield per passenger kilometer” or “yield” represents the average amount one passenger pays to fly one kilometer.

Cautionary Statements about Forward-Looking Statements

This annual report includes forward-looking statements, principally under the captions “Risk Factors,” “Operating and Financial Review and Prospects” and “Business Overview.” We have based these forward-looking statements largely on our current beliefs, expectations and projections about future events and financial trends affecting us. Many important factors, in addition to those discussed elsewhere in this annual report, could cause our actual results to differ substantially from those anticipated in our forward-looking statements, including, among other things:

- general economic, political and business conditions in Brazil and in other South American, United States and Caribbean markets we serve;

- the effects of global financial markets and economic crises;

- management’s expectations and estimates concerning our future financial performance and financing plans and programs;

- our level of fixed obligations;

- our capital expenditure plans;

- our ability to obtain financing on acceptable terms;
- inflation and fluctuations in the exchange rate of the *real*;
- existing and future governmental regulations, including air traffic capacity controls;
- increases in fuel costs, maintenance costs and insurance premiums;
- changes in market prices, customer demand and preferences, and competitive conditions;
- cyclical and seasonal fluctuations in our operating results;
- defects or mechanical problems with our aircraft;

- our ability to successfully implement our strategy;

- developments in the Brazilian civil aviation infrastructure, including air traffic control, airspace and airport infrastructure, and

- the risk factors discussed under "Risk Factors."

The words "believe," "may," "will," "aim," "estimate," "continue," "anticipate," "intend," "expect" and similar words are inter identify forward-looking statements. Forward-looking statements include information concerning our possible or assumed future results of operations, business strategies, financing plans, competitive position, industry environment, potential growth opportunities, and the effects of future regulation and the effects of competition. Forward-looking statements speak only as of the date they were made, and we undertake no obligation to update publicly or to revise any forward-looking statements after we distribute this annual report because of new information, future events or other factors. In light of the risks and uncertainties described above, the forward-looking events and circumstances discussed in this annual report might not occur and are not guarantees of future performance.

PART I

ITEM 1. Identity of Directors, Senior Management and Advisors

Not applicable.

ITEM 2. Offer Statistics and Expected Timetable

Not applicable.

ITEM 3. Key Information

A. Selected Financial Data

We present in this section the following summary financial data:

- Summary financial information derived from our audited consolidated financial statements included herein as of and for the years ended December 31, 2013, 2012 and 2011; and

- Summary financial information derived from our audited consolidated financial statements not included herein as of and for the year ended December 31, 2010 and 2009.

The following tables present summary historical consolidated financial and operating data for us for each of the periods indicated. Solely for the convenience of the reader, *real* amounts as of and for the year ended December 31, 2013 have been translated into U.S. dollars at the commercial market rate in effect on December 31, 2013 as reported by the Central Bank of R$2.343 to US$1.00.

Summary Financial Information

	Year Ended December 31,					
	2009	2010	2011	2012	2013	2013
Income Statement Data:			(in thousands of R$)			(in thousands of US$)
Operating revenues:						
Passenger	5,306,530	6,277,657	6,713,029	7,159,987	8,122,161	3,467,157
Cargo and other	718,852	701,790	826,279	943,572	834,051	356,036
Total operating revenues	**6,025,382**	**6,979,447**	**7,539,308**	**8,103,559**	**8,956,212**	**3,823,193**
Operating expenses:						
Salaries	(1,100,953)	(1,252,402)	(1,560,436)	(1,569,670)	(1,333,462)	(569,223)
Aircraft fuel	(1,813,104)	(2,287,410)	(3,060,665)	(3,742,219)	(3,610,822)	(1,541,374)
Aircraft rent	(650,683)	(555,662)	(505,058)	(644,031)	(699,193)	(298,469)
Sales and marketing	(364,551)	(367,757)	(402,568)	(426,582)	(516,059)	(220,293)
Landing fees	(312,637)	(331,882)	(395,249)	(559,421)	(566,541)	(241,843)
Aircraft and traffic servicing	(381,721)	(430,521)	(484,642)	(528,737)	(599,479)	(255,903)
Maintenance, materials and repairs	(417,212)	(422,950)	(434,181)	(417,990)	(460,805)	(196,707)
Depreciation and amortization	(142,853)	(281,604)	(395,807)	(519,631)	(560,966)	(239,463)
Other operating expenses	(428,376)	(351,464)	(633,634)	(600,891)	(342,896)	(146,374)
Gain on bargain purchase	-	-	88,428	-	-	-
Total operating expenses	**(5,612,090)**	**(6,281,652)**	**(7,783,812)**	**(9,009,172)**	**(8,690,223)**	**(3,709,649)**
Income (loss) from operations before income (expense)	413,292	697,795	(244,504)	(905,613)	265,989	113,544
Interest expense	(288,112)	(297,256)	(414,430)	(453,731)	(532,078)	(227,131)
Financial income (expense), net	630,956	(14,043)	(341,484)	(225,478)	(387,138)	(165,260)
Income (loss) before income taxes and social contribution	756,136	386,496	(1,000,418)	(1,584,822)	(653,227)	(278,847)
Income taxes	134,696	(172,299)	248,880	71,907	(71,363)	(30,463)
Net income (loss)	**890,832**	**214,197**	**(751,538)**	**(1,512,915)**	**(724,590)**	**(309,310)**

Summary Financial Information

	Year Ended December 31,					
	2009	**2010**	**2011**	**2012**	**2013**	**2013**
Income Statement Data:			(in thousands of R$)			(in thousands of US$)
Participation of Non-controlling shareholders	-	-	-	-	71,957	30,717
Participation of Controlling shareholders	**890,832**	**214,197**	**(751,538)**	**(1,512,915)**	**(796,547)**	**(340,027)**
Basic earnings (loss) per share [(1)]:	3.916	0.798	(2.78)	(5.61)	(2.62)	(1.21)
Diluted earnings (loss) per share [(1)]:	3.914	0.796	(2.78)	(5.61)	(2.62)	(1.21)
Weighted average number of outstanding shares in relation to basic earnings (loss) per share (in thousands)[(1)]	227,472	268,564	270,376	269,869	276,714	276,714
Weighted average number of outstanding shares in relation to diluted earnings (loss) per share (in thousands)[(1)]	227,583	268,954	270,376	269,869	276,714	276,714
Basic earnings (loss) per ADS [(1)]	3.916	0.798	(2.78)	(5.61)	(2.62)	(1.21)
Diluted earnings (loss) per ADS[(1)]	3.914	0.796	(2.78)	(5.61)	(2.62)	(1.21)
Dividends declared per share (net of withheld income tax) [(1)]	0.70	0.19	-	-	-	-
Dividends declared per ADS (net of withheld income tax) [(1)]	0.70	0.19	-	-	-	-

	As of December 31,					
	2009	**2010**	**2011**	**2012**	**2013**	**2013**
Balance Sheet Data:			(in thousands of R$)			(in thousands of US$)
Cash and cash equivalents	1,382,408	1,955,858	1,230,287	775,551	1,635,647	698,219
Short-term investments	40,444	22,606	1,009,068	585,028	1,155,617	493,305
Trade receivables[(2)]	519,308	303,054	354,134	325,665	324,821	138,658
Deposits	855,569	715,377	630,599	657,196	847,708	361,866
Total assets	8,720,120	9,063,847	10,655,141	9,027,098	10,638,448	4,541,299
Short-term debt	591,695	346,008	1,552,440	1,719,625	440,834	188,182
Shareholders' equity	2,609,986	2,929,169	2,205,911	732,828	1,218,500	520,149

	Year Ended December 31,					
	2009	**2010**	**2011**	**2012**	**2013**	**2013**
Other Financial Data:			(in thousands of R$ except percentages)			(in thousands of US$)
Operating margin[(3)]	6.9%	10.0%	(3.2)%	(11.2%)	3.0%	3.0%

Net cash provided by (used in) operating activities	457,259	723,897	(602,520)	133,293	403,881	172,407
Net cash provided by (used in) investing activities	5,422	(279,459)	(469,168)	(590,443)	(318,936)	(136,146)
Net cash provided by (used in) financing activities	769,238	139,900	354,547	(4,381)	807,162	344,558

Summary Operational Data

	Year Ended December 31				
	2009	**2010**	**2011**(5)	**2012**	**2013**
Operating Data:					
Revenue passengers (in thousands)	28,410	32,915	36,220	39,164	36,306
Revenue passenger kilometers (in millions)(6)	25,669	30,649	34,461	36,410	34,684
Available seat kilometers (in millions) (6)	40,355	45,937	50,373	51,867	49,633
Load-factor	63.6%	66.7%	68.4%	70.2%	69.9%
Break-even load-factor	59.2%	60.0%	70.6%	78.0%	67.8%
Aircraft utilization (block hours per day)	11.6	12.9	13.0	12.1	11.2
Average fare (R$)	191	191	185	183	224
Yield per passenger kilometer (R$ cents)	20.7	20.5	19.5	19.7	23.4
Passenger revenue per available seat kilometer (R$ cents)	13.1	13.7	13.4	13.8	16.4
Operating revenue per available seat kilometer (R$ cents)	14.9	15.2	15.0	15.6	18.0
Operating expense per available seat kilometer (R$ cents)	13.9	13.7	15.5	17.4	17.5
Operating expense less fuel expense per available seat kilometer (R$ cents)	9.4	8.7	9.4	10.2	10.2
Departures	273,602	295,160	314,190	348,578	316,466
Departures per day	750	811	861	955	867
Destinations served	59	59	63	65	65
Average stage length (kilometers)	890	907	908	877	897
Full-time equivalent employees at period end	17,963	18,776	20,525	17,726	16,319
Fuel liters consumed (in thousands)	1,291,412	1,465,299	1,591,917	1,655,421	1,511,869
Percentage of sales through website during period(4)	92.4%	88.1%	88.4%	88.8%	87.6%
Percentage of sales through website and call center during period	98.7%	95.1%	94.5%	94.5%	92.5%

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(1) Our preferred shares are not entitled to any fixed dividend preferences, but are instead entitled to receive dividends per share in the same amount of dividends per share paid to holders of our common shares. Consequently, our earnings (loss) per share are computed by dividing income by the weighted average number of all classes of shares outstanding during the year.

(2) Trade and other receivables related to receivables from credit card administrators, travel agencies, installment sales from the Voe Fácil program, cargo agencies and others. These receivables are stated at cost less allowances for doubtful receivables, which approximates their fair value given their short term nature.

(3) Operating margin represents operating income (loss) before financial results divided by operating revenues.

(4) Considering sales through our website and API (*application programming interface*) systems.

(5) Information regarding revenue passengers, aircraft utilization, average fare, departures, departures per day, average stage length, average number of operating aircraft, fuel liters consumed, percentage of sales through website and percentage of sales through website and call center include data for Webjet as of and including October 1, 2011.

(6) Source: National Civil Aviation Agency (*Agência Nacional de Aviação Civil*), or ANAC.

Exchange Rates

Brazil's foreign exchange system allows the purchase and sale of currency and the international transfer of *reais* by any person or legal entity, regardless of amount, subject to certain regulatory procedures.

The Brazilian currency has during the last decades experienced frequent and substantial variations in relation to the U.S. dollar and other foreign currencies. Most recently, the *real* was R$1.566 per US$1.00 in August 2008. Primarily as a result of the crisis in the global financial markets, the *real* depreciated 31.9% against the U.S. dollar and reached R$2.337 per US$1.00 at year end 2008. In 2009 and 2010, the *real* appreciated against the U.S. dollar and reached R$1.666 per US$1.00 at year end 2010. During 2011 the *real* depreciated and on December 31, 2011, the exchange rate was R$1.876 per US$1.00. During 2012 and 2013, the *real* continued to depreciate and on December 31, 2013, the exchange rate was R$2.343 per US$1.00.

The Central Bank has intervened occasionally to combat instability in foreign exchange rates. We cannot predict whether the Central Bank or the Brazilian government will continue to allow the *real* to float freely or will intervene in the exchange rate market through a currency band system or otherwise.

The following tables present the selling rate, expressed in *reais* to the U.S. dollar (R$/US$), for the periods indicated:

	Period-End	**Average for Period (1)**	**Low**	**High**
	(R$ per US$)			
Year				
2009	1.741	1.994	1.702	2.422
2010	1.666	1.759	1.655	1.881
2011	1.876	1.675	1.535	1.902
2012	2.044	1.955	1.702	2.112
2013	2.343	2.161	1.953	2.446
2014 (through April 22, 2014)	2.238	2.339	2.187	2.440

	Month-End	**Average for Month (2)**	**Low**	**High**
	(R$ per US$)			
Month				
October 2013	2.203	2.189	2.161	2.212
November 2013	2.325	2.295	2.243	2.336
December 2013	2.343	2.345	2.310	2.382
January 2014	2.426	2.382	2.334	2.440
February 2014	2.333	2.384	2.333	2.424
March 2014	2.260	2.330	2.260	2.365
April 2014 (through April 22)	2.238	2.232	2.187	2.280

Source: Central Bank

(1) Represents the average of the exchange rates on the last day of each month during the period.

(2) Average of the lowest and highest rates in the month.

B. Capitalization and Indebtedness

Not applicable.

C. Reasons for the Offer and Use of Proceeds

Not applicable.

D. Risk Factors

An investment in the ADSs or our preferred shares involves a high degree of risk. You should carefully consider the risks described below before making an investment decision. Our business, financial condition and results of operations could be materially and adversely affected by any of these risks. The trading price of the ADSs could decline due to any of these risks or other factors, and you may lose all or part of your investment. The risks described below are those that we currently believe may materially affect us.

Risks Relating to Brazil

The Brazilian government has exercised, and continues to exercise, significant influence over the Brazilian economy. This involvement, as well as Brazilian political and economic conditions, could adversely affect us and the trading price of our ADSs and our preferred shares.

The Brazilian government frequently has intervened in the Brazilian economy and occasionally makes significant changes in policy and regulations. The Brazilian government’s actions to control inflation and other policies and regulations have often involved, among other measures, increases in interest rates, changes in tax policies, price controls, currency devaluations and limits on imports. We and the trading price of our securities may be adversely affected by changes in policy or regulations at the federal, state or municipal levels involving or affecting factors such as:

- interest rates;
- currency fluctuations;
- inflation;
- liquidity of capital and lending markets;
- tax policies;
- exchange rates and exchange controls and restrictions on remittances abroad, such as those that were briefly imposed in 1989 and early 1990;
- outcome of the elections being held in 2014; and
- other political, social and economic developments in or affecting Brazil.

Uncertainty over whether the Brazilian government will implement changes in policy or regulation affecting these or other factors creates instability in the Brazilian economy, increasing the volatility of the Brazilian securities markets, which may have an adverse effect on us. Recent economic and political instability has led to legislative or regulatory changes that resulted in increased economic uncertainty, a negative perception of the Brazilian economy and outlook and heightened volatility in the Brazilian securities markets, which may adversely affect us and our securities.

Political crises in Brazil in the past have affected the development of the Brazilian economy and the trust of foreign investors, as well as the public in general. Recent popular unrest in Brazil has led to large demonstrations in mid-2013, which serves as an example of the population's growing dissatisfaction with corruption and certain political measures.

Developments and the perception of risk in other countries, including the United States and emerging market countries, may adversely affect the market price of Brazilian securities, including the ADSs and our preferred shares.

The market value of securities of Brazilian issuers is affected by economic and market conditions in other countries, including the United States, the European Union and emerging market countries. Although economic conditions in those countries may differ significantly from economic conditions in Brazil, investor's reactions to developments in other countries may have an adverse effect on the market value of securities of Brazilian issuers. Crisis in the United States, the European Union or emerging market countries may diminish investor interest in securities of Brazilian issuers, including ours. This could adversely affect the trading price of the ADSs or our preferred shares, and could also make it more difficult for us to gain access to the capital markets and finance our operations on acceptable terms, or at all.

Government efforts to combat inflation may hinder the growth of the Brazilian economy and could harm us.

Historically, Brazil has experienced high inflation rates. Inflation and certain actions taken by the Central Bank to curb it have had significant negative effects on the Brazilian economy. After the implementation of the *Plano Real* in 1994, the annual rate of inflation in Brazil decreased significantly, as measured by the National Broad Consumer Price Index (*Índice Nacional de Preços ao Consumidor Amplo*), or IPCA. Inflation measured by the IPCA index was 6.5%, 5.8% and 5.9% in 2011, 2012 and 2013, respectively. The inflation rate for the General Market Prices Index

(*Índice Geral de Preços de Mercado*), or IGP-M, was 5.1%, 7.8% and 5.5% in 2011, 2012 and 2013, respectively.

Between 2004 and 2010, the Central Bank's Special System for Settlement and Custody (*Sistema Especial de Liquidação e Custódia*) rate, or SELIC rate, which is the base interest rate for the Brazilian banking system, varied between 19.8% and 8.6%. On December 31, 2011, 2012 and 2013, the SELIC rate was 11.0%, 7.25% and 10.0% respectively.

Inflation and the Brazilian government's measures to fight it, principally through the Central Bank, have had and may have significant effects on the Brazilian economy and us. Tight monetary policies with high interest rates have restricted and may restrict Brazil's growth and the availability of credit. Conversely, more lenient government and Central Bank policies and interest rate decreases have triggered and may trigger increases in inflation, and, consequently, growth volatility and the need for sudden and significant interest rate increases, which could negatively affect us. In addition, we may not be able to adjust the fares we charge our customers to offset the effects of inflation on our cost structure.

Risks Relating to Us and the Brazilian Airline Industry

Substantial fluctuations in fuel costs or the unavailability of fuel would harm us.

Historically, international and local fuel prices have been subject to wide price fluctuations based on geopolitical issues and supply and demand. The price of West Texas Intermediate crude oil, a benchmark widely used for crude oil prices that is measured in barrels and quoted in U.S. dollars, which at times in 2007 and 2008 were at historically high levels, affects our fuel costs, which constitute a significant portion of our total operating expenses, accounting for 41.6% of our operating expenses for the year ended December 31, 2013. Fuel availability is also subject to periods of market surplus and shortage and is affected by demand for both home heating oil and gasoline. In the event of an international or local fuel supply shortage, our fuel prices would likely increase. Although we enter into hedging arrangements to reduce our exposure to fuel price fluctuations and have historically passed on the majority of fuel price increases by adjusting our fare structure, the price and availability of fuel cannot be predicted with any degree of certainty. Our hedging activities and fares adjustments may not be sufficient to protect us fully from fuel price increases.

Substantially all of our fuel is supplied by one source, Petrobras Distribuidora S.A., or Petrobras Distribuidora. If Petrobras Distribuidora is unable or unwilling to continue to supply fuel to us at the times and in the quantities that we require, we would be adversely affected.

Events resulting from prolonged instability in the Middle East or other oil-producing regions or the suspension of production by any significant producer, may result in substantial price increases, adverse exchange rates, or the unavailability of adequate supplies and adversely affect our profitability. In addition, the same effect may be caused by natural disasters or other significant unexpected disruptive events in regions that normally rely on other energy sources. No assurances can be given about trends in fuel prices, and average fuel prices may be significantly higher than current prices.

The airline industry is particularly sensitive to changes in economic conditions and continued negative economic conditions would likely continue to adversely affect us and our ability to obtain financing on acceptable terms.

Our operations and the airline industry in general are particularly sensitive to changes in economic conditions. Unfavorable economic conditions globally, as well as unfavorable economic conditions in Brazil, as demonstrated by a low GDP growth, a constrained credit market and increased business operating costs could reduce spending on both leisure and business travel as well as cargo transportation. Unfavorable economic conditions can also affect our ability to raise fares to counteract increased fuel, labor and other costs. Any of these factors may negatively affect us.

Unfavorable economic conditions, a significant decline in demand for air travel or continued instability of the credit and capital markets could also result in pressure on our debt costs, operating results and financial condition and would affect our growth and investment plans. These factors could also negatively affect our ability to obtain financing on acceptable terms and our liquidity generally.

Exchange rate instability may materially and adversely affect us and the market price of the ADSs and our preferred shares.

For example, the *real* was valued at R$1.67 per US$1.00 in August 2008. Following the onset of the crisis in the global financial markets, the *real* depreciated 31.9% against the U.S. dollar and reached R$2.34 per US$1.00 at the end of 2008. In 2010, the *real* appreciated against the U.S. dollar, reaching R$1.661 per US$1.00 at the end of 2010. In 2011, the *real* depreciated against the U.S. dollar, reaching R$1.867 per US$1.00 at the end of 2011. In 2012 and 2013, the *real* depreciated against the U.S. dollar, reaching R$2.343 per US$1.00 as of December 31, 2013. There can be no assurance that the *real* would not depreciate or appreciate further against the U.S. dollar, notwithstanding Brazilian government's efforts to keep the exchange rate at current levels.

Depreciation of the *real* against the U.S. dollar could create inflationary pressures in Brazil and cause increases in interest rates, which could negatively affect the growth of the Brazilian economy as a whole, curtail access to foreign financial markets and prompt government intervention, including recessionary governmental policies. Depreciation of the *real* against the U.S. dollar can also, as in the context of an economic slowdown, lead to decreased consumer spending, deflationary pressures and reduced growth of the economy as a whole. On the other hand, appreciation of the *real* relative to the U.S. dollar and other foreign currencies could lead to a deterioration of the Brazilian foreign exchange current accounts, as well as dampen export-driven growth. Depending on the circumstances, either depreciation or appreciation of the *real* could materially and adversely affect us.

Substantially all of our passenger revenue and cargo revenue and temporary investments are denominated in *reais* and a significant part of our operating expenses, such as fuel, aircraft and engine maintenance services, aircraft rent payments and aircraft insurance, are denominated in, or linked to, U.S. dollars. For the year ended December 31, 2013, 55.1% of our operating expenses were either denominated in or linked to the U.S. dollar. In addition, the purchase price of the Boeing 737 aircraft is denominated in U.S. dollars. At the end of 2013, R$4,346.4 million or 77.8% of our indebtedness was denominated in U.S. dollars and we had a total of R$4,094.0 million in U.S. dollar-denominated future operating lease payment obligations. We are also required to maintain U.S. dollar-denominated deposits and maintenance reserve deposits under the terms of some of our aircraft operating leases. We may incur substantial additional amounts of U.S. dollar-denominated operating leases or financial obligations and U.S. dollar-denominated indebtedness and be subject to fuel cost increases linked to the U.S. dollar. While in the past we have generally adjusted our fares in response to, and to alleviate the effect of, depreciation of the *real* and increases in the price of jet fuel (which is priced in U.S. dollars) and have entered into hedging arrangements to protect us against the short-term effects of such developments, there can be no assurance we will be able to continue to do so. In addition, there is no economically viable hedging alternative for medium- and long-term depreciation of the *real*.

Depreciation of the *real* also reduces the U.S. dollar value of distributions and dividends on the ADSs and the U.S. dollar equivalent of the market price of our preferred shares and, as a result, the ADSs.

Changes to Brazilian rules regarding slots distribution, fare restrictions and fees associated with civil aviation may adversely affect us.

In February 2013, ANAC announced a series of public hearings to discuss proposed changes to rules governing the allocation of slots at Brazilian airports, which would consider operational efficiency (punctuality and regularity) as the main determinant for the allocation of slots.

Also in February 2013, the Civil Aviation Secretary, or SAC, announced a new proposal focused specifically on slot distribution rules at Congonhas airport (São Paulo). SAC's proposal would alter current regulation and takes into account operational efficiency as a principal determinant for slot allocation at Congonhas airport, as well as domestic market (main cities) and regional market share as complementary factors.

The new proposals, which are currently being reviewed by the Brazilian Legislature and Executive members, may change the current slot allocation criteria and as a result reduce our number of slots at Brazil's main airports. If there is a change in the rule regarding slots redistribution we could be negatively affected by higher competition in this airport from new competitors. During the course of public hearings held in connection with these proposed changes, the Brazilian Association of Airline Companies (*Associação Brasileira das Empresas Aéreas*), or ABEAR, sent a proposal which included a request for the creation of additional slots, which would be preferably awarded to new entrants.

Changes to the Brazilian civil aviation regulatory framework may adversely affect us.

Brazilian aviation authorities monitor and influence the developments in Brazil's airline market. For example, in airports regulated by the Brazilian Airport Infrastructure Company (*Empresa Brasileira de Infraestrutura Aeroportuária*), or INFRAERO, INFRAERO addressed overcapacity by establishing strict criteria that must be met before new routes or additional flight frequencies are awarded. INFRAERO's policies as well as those of other aviation supervisory authorities have in the past, and may continue to, negatively affect our operations.

In August 2011, the Brazilian government privatized the new Natal airport, which construction is on the verge of completion. In February 2012, the Brazilian government privatized the Guarulhos, Brasília and Campinas international airports, which will be operated by the winners of the privatization auction for periods of 20 to 30 years. In November 2013, the Brazilian government privatized Galeão (Rio de Janeiro) and Confins (Belo Horizonte) airports. Other airports may also be privatized in the future, although the government has announced there are no current plans. We are unable to foresee the effect that these privatizations will have on us, especially on our operational efficiencies, during periods of construction and renovation, and our operational costs. We may, for example, incur additional fees charged by the new operators of these airports without a comparable improvement in the efficiencies of the same airport. See "Regulation of the Brazilian Civil Aviation Market–Airport Infrastructure."

Changes to the Brazilian civil aviation regulatory framework may alter the competitive dynamics of our industry and may adversely affect our operations, see "–We operate in a highly competitive industry."

Technical and operational problems in the Brazilian civil aviation infrastructure, including air traffic control systems, airspace and airport infrastructure may have a material adverse effect on us.

We are dependent on improvements in the coordination and development of Brazilian airspace control and airport infrastructure, which, mainly due to the large growth in civil aviation in Brazil in recent years, require substantial improvements and government investments. This dependence is underlined by the need for additional infrastructure investments for the World Cup (2014) and the Summer Olympics (2016) in Brazil.

If the measures taken and investments made by the Brazilian government and regulatory authorities do not prove sufficient or effective, air traffic control, airspace management and sector coordination-related difficulties might reoccur or worsen, which might have a material adverse effect on us.

Slots at Congonhas Airport in São Paulo, the most important airport for our operations, are fully utilized. The Santos-Dumont airport in Rio de Janeiro, a highly utilized airport with half-hourly shuttle flights between São Paulo and Rio de Janeiro, has certain slot restrictions. Several other Brazilian airports, for example the Brasília, Campinas, Salvador, Confins and São Paulo (Guarulhos) international airports, have limited the number of slots per day due to infrastructural limitations at these airports. Any condition that would prevent or delay our access to airports or routes that are vital to our strategy or our inability to maintain our existing slots, and obtain additional slots, could materially adversely affect our operations. In addition, we cannot assure that any investments will be made by the Brazilian government in the Brazilian aviation infrastructure to permit a capacity increase at busy airports and consequently additional concessions for new slots to airlines.

As a result of significant losses in 2011, 2012 and 2013, our financial condition has been materially weakened.

Significant losses in 2011, 2012 and 2013 have materially weakened our financial condition. We had net losses of R$752 million in 2011, R$1,513 million in 2012 and R$725 million in 2013. These losses were mainly a factor of increased operating expenses that we do not control, including: a 24.6% increase in average aircraft fuel prices over the course of the last three years, a 22.9% depreciation of the *real* against the U.S. dollar over the same period, which affects a significant part of our operating expenses, and a 43.3% increase in expenses with landing fees over the same period.

Although we have taken a number of steps to reduce the effects of these increased operating expenses, such as reducing capacity and focusing on more profitable routes, we cannot assure you that these measures will be sufficient to offset the effects of these increased expenses, that these expenses will not continue to increase and, if they continue to increase, that we will be able to pass on these increases to our customers or otherwise compensate for the increases, which would materially and adversely affect us.

We may be unable to reduce our leverage ratios over time. Consequently, our ability to obtain low-cost financing has been materially weakened

We have a large amount of indebtedness (leverage) in relation to our equity. As of December 31, 2013, we had approximately R$5,589 million of consolidated indebtedness as compared to a shareholders' equity of R$1,219 million. This increased leverage results from our recent significant losses.

As a result of a decrease in our operational results in 2012 and increased leverage, Fitch Ratings downgraded our credit rating from B+ to B- in 2013. In the beginning of 2014, Fitch Ratings revised our rating outlook from negative to stable. Credit ratings affect the cost and other terms upon which we are able to obtain funding. Credit rating agencies regularly evaluate us and their ratings of our long-term debt are based on a number of factors, including our financial strength. We cannot assure you that credit rating agencies will not downgrade our credit ratings any further, even absent new losses.

In addition, in 2010, the Ex-Im Bank agreed on a common approach with European export-credit agencies on offering export credits for commercial aircraft. Among other things, the new Sector Understanding on Export Credits for Civil Aircraft, or the ASU, sets forth minimum guarantee premium rates applicable to aircraft delivered on or after January 1, 2013, or under firm contracts entered into after December 31, 2010 and also changes the maximum amount that may be financed.

In light of our current credit ratings and the introduction of the ASU, our minimum guaranty premium rate applicable to aircraft delivered on or after January 1, 2013 increased substantially. As a consequence, finance leases have become significantly more expensive and we have therefore entered nearly exclusively into operating leases in 2012 and 2013.

Our substantial indebtedness or any further downgrades to our credit ratings would adversely affect our ability to obtain financing on terms that are favorable to us, or at all, and could also make us more vulnerable to unexpected events or to the deterioration of the operating environment (such as a significant increase in operating expenses).

Certain of our debt agreements contain financial covenants and any default under these debt agreements may have a material adverse effect on us.

Certain of our existing debt agreements contain covenants that require the maintenance or satisfaction of specified financial ratios. Our ability to meet these financial ratios can be affected by events beyond our control and we cannot assure that we will meet those ratios. Failure to meet or satisfy any of these covenants could result in an event of default under these agreements and others, as a result of cross-default provisions. If we are unable to comply with our debt covenants, we would be forced to seek waivers. We cannot guarantee that we will be successful in obtaining any waivers or renewing existing waivers. On December 18, 2013, we received a waiver for our Debentures IV and V. See "Item 5. Operating and Financial Review and Prospects—B. Liquidity and Capital Resources—Indebtedness—Covenant Compliance" and note 18 to our financial statements for more information. If we are unable to renew these and/or receive other waivers, a large portion of our debt could be subject to acceleration and we may need to renegotiate, restructure or refinance our indebtedness, seek additional equity capital or sell assets, which may materially and adversely affect us.

We have significant recurring aircraft lease costs, and we will incur significantly more fixed costs that could hinder our ability to meet our strategic goals.

We have significant costs, relating primarily to leases for our aircraft and engines. As of December 31, 2013, we had commitments of R$36,550.1 million to purchase additional Boeing 737-800 Next Generation aircraft, based on aircraft list prices, although the actual price payable by us for the aircraft should be lower due to supplier discounts. As of December 31, 2013, we had R$5,170.1 million in short and long-term indebtedness, excluding our perpetual bonds in the amount of R$419.3 million. We expect that we will incur additional fixed obligations and debt as we take delivery of the new aircraft and other equipment to implement our strategy.

Having significant fixed payment obligations could:

- limit our ability to obtain additional financing to support expansion plans and for working capital and other purposes;

- divert substantial cash flow from our operations to service our fixed obligations under aircraft operating leases and aircraft purchase commitments;

- if interest rates increase, require us to incur significantly more lease or interest expense than we currently do; and

- limit our ability to react to changes in our business, the airline industry and general economic conditions.

Our ability to make scheduled payments on our fixed obligations, will depend on our operating performance and cash flow, which will in turn depend on prevailing economic and political conditions and financial, competitive, regulatory, business and other factors, many of which are beyond our control. In addition, our ability to raise our fares to compensate for an increase in our fixed costs may be limited by competition and regulatory factors.

We operate in a highly competitive industry.

We face intense competition on domestic routes in Brazil from existing scheduled airlines, charter airlines and potential new entrants in our market. In addition to competition among scheduled airline companies and charter operators, the Brazilian airline industry faces competition from ground transportation alternatives, such as interstate buses. We may also face competition from international airlines as they introduce and expand flights between Brazil, other South American and U.S. and Caribbean destinations. In addition, the Brazilian government and regulators could give preference to new entrants when granting new and current slots in Brazilian airports, for example, as suggested in a recent proposal from ANAC with respect to the new slots in the Congonhas airport.

Existing and potential new competitors may be stronger than us. They have in the past and may again undercut our fares or increase capacity on their routes in an effort to increase their market share of business traffic (high value-added customers). In any such event, we cannot assure you that our level of fares or passenger traffic would not be adversely affected.

Further consolidation in the Brazilian and global airline industry framework may adversely affect us.

As a result of the competitive environment there may be further consolidation in the Brazilian and global airline industry, whether by means of acquisitions, joint ventures, partnerships or strategic alliances. We cannot predict the effects of further consolidation on the industry. To the extent we act as consolidators, we may not be able to successfully integrate the business and operations of companies acquired, governmental approvals may be delayed, costs of integration and fleet renovation may be greater than anticipated, synergies may not meet our expectations, our costs may increase and our operational efficiency may be reduced, all of which would negatively affect us.

If we do not act as a consolidator, our competitors may increase their scale, diversity and financial strength, which would negatively affect us. Consolidation in the airline industry and changes in international alliances will continue to affect the competitive landscape in the industry and may result in the formation of airlines and alliances with increased financial resources, more extensive global networks and reduced cost structures.

New and existing regulations and government actions regarding the repatriation of funds as well as the devaluation of currencies in foreign countries where we have operations could adversely affect us.

Changes in the regulations regarding the repatriation of funds as well as the excessive devaluation of currencies could limit our ability to timely transfer, in an economically viable manner, cash held in foreign countries where we have operations.

For example, in 2013, the Venezuelan government announced new levels of exchange rates applicable to certain sectors, including the airline sector. The exchange rate for foreign airlines ceased to be the CADIVI exchange rate, which was VEF 6.30 per US$ 1.00 as of February 13, 2013, and is now set at weekly auctions known as SICAD, at VEF 10.70 per US$ 1.00 as of March 31, 2014. Although the Venezuelan government has assured the general public that such exchange rates will not apply to cash held in Venezuela prior to the resolution setting forth the new exchange rate levels, we cannot anticipate whether we will be able to timely transfer, in an economically viable manner, cash currently held in Venezuela. As of December 31, 2013, we had R$251.2 million in cash held in our subsidiaries outside Brazil, of which R$195.1 million were held in Venezuela. In light of the devaluation of the Venezuelan currency since December 31, 2013, we will record, as of March 31, 2014, a R$75.9 million impairment in connection with these funds.

In addition, political and economic instability as well as recent regulations restricting the repatriation of funds in Argentina could adversely affect us. We cannot anticipate whether we will be able to timely transfer, in an economically viable manner, cash currently held in Argentina.

We rely on one supplier for our aircraft and engines.

One of the key elements of our current business strategy is to save costs by operating a standardized aircraft fleet. After extensive research and analysis, we chose the Boeing 737-700/800 Next Generation aircraft and CFM 56-7B engines from CFM International. We expect to continue to rely on Boeing and CFM International into the foreseeable future and have made a purchase order for 60 Boeing 737 Max-7/8 aircraft (the newest generation of our current aircraft and still under development), to be delivered starting 2018. If either Boeing or CFM International were unable to perform its contractual obligations, we would have to find another supplier for a similar type of aircraft or engines.

If we had to lease or purchase aircraft from another supplier, we could lose the benefits we derive from our current fleet composition. We cannot assure you that any replacement aircraft would have the same operating advantages as the Boeing 737-700/800 Next Generation aircraft or that we could lease or purchase engines that would be as reliable and efficient as the CFM engines. This may be the case for instance with the Boeing 737 Max-7/8 aircraft. We will also incur substantial transition costs, including costs associated with retraining our employees, replacing our manuals and adapting our facilities. Our operations could also be disrupted by the failure or inability of Boeing or CFM International to provide sufficient parts or related support services on a timely basis.

We would also be significantly harmed if a design defect or mechanical problem with the Boeing 737-700/800 Next Generation aircraft or the CFM engines used on our aircraft was discovered, causing our aircraft to be grounded while any such defect or problem is being corrected, assuming it could be corrected at all. The use of our aircraft could be suspended or restricted by ANAC in the event of any actual or perceived mechanical, design or other problems while ANAC conducts an investigation. Our business would also be significantly harmed if the public avoids flying on our aircraft due to an adverse perception of the Boeing 737-700/800 Next Generation aircraft or the CFM engines because of safety concerns or other problems, whether real or perceived, or in the event of an accident involving Boeing 737-700/800 Next Generation aircraft or the CFM engines.

We have made purchase orders for new aircraft that is still being developed, any project delays or operational difficulties would adversely affect our operational costs and results of operation.

In 2012, Boeing and CFM released new aircraft and engines, the Boeing 737 Max-7/8 and LEAP-1B, to replace the Boeing 737-700/800 Next Generation. Any project delays or operational difficulties with this new aircraft and engines could create an adverse perception about our fleet, cancelations and decrease in the number of orders, therefore adversely affecting us.

In addition, when these aircraft and engines are delivered and operational, it could cause the market value of our other aircraft and engines to decrease, which would negatively affect the value of our assets and could result in us recording impairment charges.

We rely heavily on automated systems to operate our business*, *and any failure of these systems could harm us.

We depend on automated systems to operate our business, including our computerized airline ticket sales system, our telecommunication systems, our scheduling system and our website. Our website and ticket sales system must accommodate a high volume of traffic and deliver important flight information. Substantial or repeated website, ticket sales, scheduling or telecommunication systems failures could reduce the attractiveness of our services and could cause our customers to purchase tickets from another airline. Any disruption in these systems could result in the loss of important data, increase our expenses and generally harm us. As an example, in September 2013, the Navitaire system used by several airlines, including us, suffered from connection failures and remained offline for approximately 12 hours. This led to delays in the sales of tickets and delivery of important flight information.

We rely on maintaining a high daily aircraft utilization rate to increase our revenues and reduce our costs.

One of the key elements of our business strategy is to maintain a high daily aircraft utilization rate. High daily aircraft utilization allows us to generate more revenue from our aircraft and dilute our fixed costs, and is achieved in part by operating with quick turnaround times at airports so we can fly more hours on average in a day. Our rate of aircraft utilization could be adversely affected by a number of different factors that are beyond our control, including, among others, air traffic and airport congestion, adverse weather conditions and delays by third-party service providers relating to matters such as fueling and ground handling.

Our reputation, operations and financial results could be harmed by events out of our control

Accidents or incidents involving our aircraft could involve significant claims by injured passengers and others, as well as significant costs related to the repair or replacement of a damaged aircraft and its temporary or permanent loss from service. We are required by ANAC and lessors of our aircraft under our operating lease agreements to carry liability insurance. Although we believe we currently maintain liability insurance in amounts and of the type generally consistent with industry practice, the amount of such coverage may not be adequate and we may be forced to bear substantial losses in the event of an accident. Substantial claims resulting from an accident in excess of our related insurance coverage would harm us. Moreover, any accident or incident involving our aircraft, even if fully insured, or an accident or incident involving Boeing 737 Next Generation aircraft or the aircraft of any major airline could cause negative public perceptions about us or the air transport system, which would harm us.

We may also be affected by other events that affect travel behavior, such as the potential of epidemics or acts of terrorism. These events are out of our control and may affect us even if occurring in markets where we do not operate and/or in connection with other airlines. For example, in the second quarter of 2009 an outbreak of the H1N1 virus had an adverse impact on global air travel and on our operations to and from Argentina. In addition, in the past there have been concerns about outbreaks or potential outbreaks of other diseases, such as avian flu and Severe Acute Respiratory Syndrome, or SARS, which had an adverse impact on global air travel. Any outbreak of a disease that affects travel behavior could have a material adverse impact on us and the worldwide airline industry. Outbreaks of disease could also result in quarantines of our personnel or an inability to access facilities or our aircraft, which could adversely affect our operations.

Natural disasters may affect and disrupt our operations. For example, in 2011, a volcanic eruption in Chile had a prolonged adverse effect on air travel, halting flights in Argentina, Chile, Uruguay and the southern part of Brazil for several days. As a result, our operations to and from these regions were temporarily disrupted. Any natural disaster that affects air travel in the regions in which we operate could have a material adverse impact on us.

Our controlling shareholder has the ability to direct our business and affairs and its interests could conflict with yours.

Our controlling shareholder has the power to, among other things, elect a majority of our directors and determine the outcome of any action requiring shareholder approval, including transactions with related parties, corporate reorganizations, dispositions, and the timing and payment of any future dividends, subject to minimum dividend payment requirements imposed under Law No. 6,404 of December 15, 1976, as amended, or the Brazilian corporation law. Although you are entitled to tag-along rights in connection with a change of control of our company and you will have specific protections in connection with transactions between our controlling shareholder and related parties, our controlling shareholder may have an interest in pursuing acquisitions, dispositions, financings or similar transactions that could conflict with your interests as a holder of the ADSs or our preferred shares.

Brazilian courts may rule against us in lawsuits related to the non-levy of the ICMS tax.

In 2001, we commenced proceedings against the Brazilian state revenue service, in which we claim an exemption from the payment of Brazilian value added tax (*Imposto Sobre Circulação de Mercadorias e Serviços*), or ICMS, purportedly due on imported aircraft, parts and engines. On May 30, 2007, the Federal Supreme Court (*Supremo Tribunal Federal*), or STF, ruled in our favor in respect of one of these cases, however, various of the proceedings relating to this matter are still pending. The estimated aggregated amount of the ongoing lawsuits related to the non-levy of ICMS tax on said imports is R$229 million as of December 31, 2013, adjusted for inflation, not including late payment charges. Based on our legal counsel's opinion, we understand that the likelihood of loss is remote and thus did not recognize provisions for these amounts. The outcome of these lawsuits and proceedings cannot be anticipated and an unfavorable decision would negatively affect us.

Risks Relating to the ADSs and Our Preferred Shares

The relative volatility and illiquidity of the Brazilian securities markets, and securities issued by airlines in particular, may substantially limit your ability to sell the preferred shares underlying the ADSs at the price and time you desire.

Investing in securities that trade in emerging markets, such as Brazil, often involves greater risk than investing in securities of issuers in the United States, and such investments are generally considered to be more speculative in nature. The Brazilian securities market is substantially smaller, less liquid, more concentrated and can be more volatile than major securities markets in the United States. Accordingly, although you are entitled to withdraw the preferred shares underlying the ADSs from the depositary at any time, your ability to sell the preferred shares underlying the ADSs at a price and time at which you wish to do so may be substantially limited. There is also significantly greater concentration in the Brazilian securities market than in major securities markets in the United States. The ten largest companies in terms of market capitalization represented 51.2% of the aggregate market capitalization of the BM&FBOVESPA S.A. Bolsa de Valores, Mercadorias & Futuros ("BM&FBOVESPA") as of December 31, 2013. The top ten stocks in terms of trading volume accounted for 53.6%, 46.0% and 45.5% of all shares traded on the BM&FBOVESPA in 2011, 2012 and 2013 respectively.

In addition, the trading price of shares of companies in the worldwide airline industry are relatively volatile and investors' perception of the market value of these shares, including our ADSs and preferred shares, may also be negatively impacted with additional volatility and decreases in the price of our ADSs and preferred shares.

Holders of the ADSs and our preferred shares may not receive any dividends.

According to our by-laws, we must pay our shareholders at least 25.0% of our annual net income as dividends, as determined and adjusted under Brazilian corporation law. This adjusted income may be capitalized, used to absorb losses or otherwise appropriated as allowed under the Brazilian corporation law and may not be available to be paid as dividends. We may not pay dividends to our shareholders in any particular fiscal year if our board of directors determines that such distributions would be inadvisable in view of our financial condition.

If you surrender your ADSs and withdraw preferred shares, you risk losing the ability to remit foreign currency abroad and certain Brazilian tax advantages.

As an ADS holder, you benefit from the electronic foreign capital registration obtained by the custodian for our preferred shares underlying the ADSs in Brazil, which permits the custodian to convert dividends and other distributions with respect to the preferred shares into non-Brazilian currency and remit the proceeds abroad. If you surrender your ADSs and withdraw preferred shares, you will be entitled to continue to rely on the custodian's electronic foreign capital registration for only five business days from the date of withdrawal. Thereafter, upon the disposition of or distributions relating to the preferred shares, you will not be able to remit abroad non-Brazilian currency unless you obtain your own electronic foreign capital registration.

If you attempt to obtain your own electronic foreign capital registration, you may incur expenses or suffer delays in the application process, which could delay your ability to receive dividends or distributions relating to our preferred shares or the return of your capital in a timely manner. The depositary's electronic foreign capital registration may also be adversely affected by future legislative changes.

Holders of ADSs may be unable to exercise preemptive rights with respect to our preferred shares.

We may not be able to offer our preferred shares to "U.S. Holders," of ADSs pursuant to preemptive rights granted to holders of our preferred shares in connection with any future issuance of our preferred shares unless a registration statement under the Securities Act is effective with respect to such preferred shares and preemptive rights, or an exemption from the registration requirements of the Securities Act is available. We are not obligated to file a registration statement relating to preemptive rights with respect to our preferred shares, and we cannot assure you that we will file any such registration statement. If such a registration statement is not filed and an exemption from registration does not exist, Citibank, N.A., as depositary, will attempt to sell the preemptive rights, and you will be entitled to receive the proceeds of such sale. However, these preemptive rights will expire if the depositary does not sell them, and U.S. Holders of ADSs will not realize any value from the granting of such preemptive rights.

ITEM 4. Information on the Company

A. History and Development of the Company

General

We were formed on March 12, 2004 as a *sociedade por ações*, a stock corporation, duly incorporated under the laws of Brazil for an unlimited term. Our material assets consist of shares of VRG, shares of Smiles S.A., or Smiles, four offshore subsidiaries, cash and cash equivalents and short-term investments. Our principal executive offices are located at Praça Comandante Linneu Gomes, S/N, Portaria 3, Jardim Aeroporto, CEP: 04626-020, São Paulo, SP, Brazil and the telephone number of our investor relations department is +55 11 2128-4700. Our website is www.voegol.com.br and investor information may be found on our website under www.voegol.com.br/ir. Information contained on our website is not incorporated by reference herein, and will not be considered a part of this annual report.

Capital Expenditures

For a description of our capital expenditures, see below "Item 5. Operating and Financial Review and Prospects—Liquidity and Capital Resources."

B. Business Overview

We are one of the largest low-cost carriers in the world, according to the International Air Transport Association, or IATA, in terms of passengers transported in 2013, and the largest low-cost carrier in Latin America. We provide frequent service on routes connecting all of Brazil's major cities and from Brazil to major cities in South America and selected tourist destinations in the Caribbean and the United States.

Since the beginning of our operations in 2001, our affordable, reliable and simple service, and our focus on markets that were either underserved or did not have a lower-fare alternative, have led to a strong awareness of our brand and a rapid increase in our market share. We were the first company to successfully introduce low-cost carrier industry practices and technologies in Latin America. We have a young and standardized operating fleet of 137 Boeing 737-700/800s, or Boeing 737 aircraft and our convenient flight network offers the highest number of daily departures out of all airline companies in Latin America.

Since 2012, we have increased our focus on business passengers (high value-added customers), diversifying our revenue base from leisure passengers. Our strategy is to increase our share in this market while at the same time consolidating our leadership in flight network. We also intend to expand the *Smiles* loyalty program, one of the largest loyalty programs in Latin America with approximately 9.7 million members and 215 partners, as of December 31, 2013, and a variety of attractive ancillary businesses, such as our air cargo services, or *Gollog*. Passenger transportation revenues represented 91% and ancillary revenues represented 9% of our net revenues of R$8,956.2 million in 2013.

As of March 31, 2014, we offered approximately 910 daily flights to 65 destinations connecting the most important cities in Brazil as well as key destinations in Argentina, Bolivia, Paraguay, Uruguay, Venezuela, the United States and the Caribbean. We strategically focus on the Brazilian and South American markets, and will continue to carefully evaluate opportunities to continue growing by increasing flights to our existing high-demand markets and adding routes to new markets with high potential (for example, in the United States and Caribbean), all of which can be reached with our Boeing 737 Next Generation (NG) aircraft.

Our Competitive Strengths

We Have a Strong Market Position Based on Slots at the Most Important Airports in Brazil. Since 2007, we have been the carrier with the most flights connecting the busiest airports in Brazil: Congonhas and Guarulhos (São Paulo), Santos Dumont and Galeão (Rio de Janeiro), Juscelino Kubitschek (Brasília), Confins (Belo Horizonte), Magalhães (Salvador), Salgado Filho (Porto Alegre), Gilberto Freyre (Recife) and Afonso Pena (Curitiba), our consolidated flight network. Routes between these airports are among the most profitable routes in our markets, with strong yields achieved mostly from business travelers.

We Keep Our Operating Costs Low. Our operating expense per available seat kilometer (CASK), ex-fuel, for 2013 was R$10.23 cents. We believe that our CASK for 2013, adjusted for the average number of kilometers flown per flight, or adjusted by stage length, was one of the lowest among global peers, based upon our analysis of data collected from publicly available information. Our business model is based on innovation and best practices adopted to improve our operating efficiency, including:

- *Operation of a young and standardized fleet.* At December 31, 2013, our operating fleet of 137 Boeing 737 aircraft was one of Latin America's largest and youngest fleets, with an average age of 7.1 years. Advanced technology present or installed in our newer aircraft have reduced fuel consumption. We plan to keep our operating fleet exclusively comprised of Boeing 737 aircraft, until the arrival of our newly ordered Boeing 737 Max-7/8 aircraft (the newest generation of our current aircraft), which we expect will be delivered beginning in 2018. Having a standardized fleet reduces inventory costs, as it requires fewer spare parts, and eliminates the need to train our pilots to operate different types of aircraft. It also simplifies our maintenance and operations processes.

- *State of the art maintenance.* We carry out heavy maintenance on our Boeing 737 aircraft internally at our IOSA (IATA Operational Safety Audit) certified Aircraft Maintenance Center at the Tancredo Neves International Airport located in Confins, in the State of Minas Gerais. With our system of phased maintenance for our Boeing 737 fleet, we are able to perform maintenance work every day without sacrificing aircraft revenue time and schedule preventive maintenance with more regularity and without interrupting the utilization of our aircraft, which further dilutes fixed costs. Since April 2012, our Aircraft Maintenance Center has also been certified by ANAC to provide conventional and electrostatic painting, weighing and recalibration services for aircraft owned or operated by other airlines.

- *We have one of the largest e-commerce platforms in Brazil.* Our effective use of technology helps to keep our costs low and our operations highly scalable and efficient. We seek to keep our distribution channels streamlined and convenient so as to allow our customers to interact with us via the internet. In 2013, we booked 87.6% of our ticket sales through a combination of our website and application programming interface, or API, 4.9% through our call center and 7.5% through Global Distribution System, or GDS. In addition, in the main airports used by business passengers, the rate of remote check-ins totaled approximately 60% of all clients in the final quarter of 2013.

We Are Majority Shareholders of Smiles, a Company With One of the Largest Loyalty Programs in Latin America. With the acquisition of VRG in April 2007, we also acquired the *Smiles* loyalty program, which is available to all our passengers and which we consider a strong relationship tool. The *Smiles* loyalty program has partnerships with 215 partners, including hotel chains, car rental companies, restaurants, insurance companies, publishers and schools and also forms the basis for partnerships with some of Brazil and South America's largest banks and credit card companies. The *Smiles* loyalty program had approximately 9.7 million members at December 31, 2013. See "*Smiles* Loyalty Program."

We Have Strong Brand Recognition. We believe that the Gol brand has become synonymous with innovation and value in the airline industry. Our customers identify Gol as being safe, accessible, friendly, fair, intelligent and reliable and distinguish Gol in Brazil's domestic airline industry on the basis of its modern and simplified approach to air travel services. Brand and product diversification among *Smiles*, *Gollog* and *Gol+Conforto* brands available on our website are recognized by customers in various businesses and represent an important tool for us.

We Have High Corporate Governance Standards and Proven Management. We have three independent board members and one board member who is nominated by Delta Air Lines Inc., or Delta, pursuant to our partnership agreement. Our top managers have broad experience in many sectors of the Brazilian economy, including air and ground transportation, telecommunications and consumer products. This experience has helped us to develop the most effective elements of our low-cost model and we expect will help us further penetrate the Brazilian middle-class, as well as the business passenger market, and generate ancillary revenues.

Our Strategies

Our strategy is to capitalize on our competitive advantages to achieve sustainable growth, based on four main strategic pillars: increase passenger revenue, expand ancillary revenues, further reduce costs and improve our financial resilience. In order to implement our strategies we intend to:

Capitalize on Our Strong Market Position in Brazil and Latin America. We intend to capitalize on our strong market position, our widespread brand recognition, the greatest number of business routes and highest frequencies between the most important airports in Brazil, our consolidated flight network and the *Smiles* loyalty program, to increase penetration across all segments of travelers. We will focus on Brazilian operations and selected South American destinations. We will also consider new routes to foreign markets with high growth potential, for example, in the Unites States and the Caribbean, which fit our flight network and can be reached with our current Boeing 737 aircraft. In addition, we believe that the airline industry may experience further consolidation and therefore believe that establishing partnerships and alliances with other airlines will be a key factor to our success. In this environment we intend to play a leading role in the Latin American airline industry and to strengthen our position as a long-term player in the face of potential consolidations of the industry.

Improve Operating Efficiency. Reducing our operating expense per available seat kilometer (CASK) and adjusting capacity are key to improving our profitability. We aim to maintain our position as one of the lowest cost airlines in the world. We intend to adjust our strategy to focus on more profitable routes and to further reduce the average age of our fuel-efficient fleet, to ensure we are responsive to current market conditions while maintaining high utilization rates. Our aircraft utilization rate was 11.2 block-hours per day in 2013, as compared to 12.1 block-hours per day in 2012 and to 13.0 block-hours per day in 2011.

We seek to reduce our CASK by using our aircraft efficiently, concentrating on minimizing our turnaround times at airports and maintaining a high number of daily flights per aircraft. We will continue to utilize technological innovations wherever possible to reduce our distribution costs and improve our operating efficiency.

Maintain a Strong Cash Position. We currently seek to maintain an adequate cash position and to lengthen the maturity profile of our financial liabilities, avoiding the concentration of significant debt maturities over the next two years. In April, 2013, we conducted an initial public offering of Smiles. The proceeds of this initial public offering, or IPO, were used for the advance purchase of our flight tickets, in the amount of approximately R$1.1 billion. On December 31, 2013, we maintained a total of R$3,045.7 million in cash, cash equivalents, financial investments and short and long-term restricted cash.

Expand Our Customer Base. In planning the growth of our business, we will continue to select our routes and build the frequency of our service based on the extent and type of demand in the areas we serve in Brazil, South America, the Unites States and the Caribbean. We will continue to offer products across all traveler segments, offering convenient and flexible alternatives to business travelers while still making low-fare flights more accessible to a larger portion of the population, through the following measures:

- *Increased focus on business travelers.* We intend to maintain our high punctuality, 92% and 94% in 2012 and 2013, respectively, and regularity, 95% in 2012 and 2013, both key elements in the purchase decision of business travelers. In order to achieve this level of operational performance, we implemented the fast travel concept, a series of measures which reduced boarding time. In addition, we offer higher-rate fares that allow flexibility to reschedule or cancel tickets with little advance notice and no additional costs, higher mileage multiplier in the Smiles loyalty program, more functional visual identity, signs, bilingual communication, and, on São Paulo – Rio de Janeiro shuttle flights, the new and exclusive Gol+ product, aircrafts which configuration allows for additional legroom, and the *Gol+Conforto* seats, the first rows in which the middle seat is blocked and passengers are able to take advantage of additional legroom and recline. In February 2013, we implemented a new route network designed to better meet the needs of business travelers by offering even more convenient flight times and connections.

- *Stimulating demand.* Our widely available service is also designed to popularize air travel and stimulate demand, particularly from fare-conscious leisure travelers and business travelers, working for small to mid-sized companies, who might otherwise use alternative forms of transportation or not travel at all. The Brazilian middle class has grown significantly in the last few years, from 66 million in 2003 to 104 million in 2012, according to Secretary for Strategic Affairs (*Secretaria de Assuntos Estratégicos*), or SAE.

- *More destinations*. We have increased our operations by including new destinations in our network, for example, Santo Domingo (Dominican Republic), Miami and Orlando, which were added by the end of 2012. Also, we will resume flights to Santiago, in Chile, in July, 2014, after we obtain all applicable authorizations.

Strengthen the Smiles Loyalty Program. We intend to further strengthen the *Smiles* loyalty program by increasing interaction with members and adding perceived value to its members through the following initiatives:

- *Separate entity*. In 2013, we segregated the *Smiles* loyalty program activities into Smiles. In May 2013, Smiles concluded its approximately R$1.1 billion initial public offering, which allowed for the creation of a fully dedicated management team that will pursue all business opportunities from the growth of this market in Brazil.

- *New Products*. Before the segregation of Smiles, in 2012, we launched products that are now within the *Smiles* loyalty program structure: (i) an online platform allowing members to redeem tickets in partner airlines though our website; (ii) a miles purchase program, creating an alternative for members to supplement their balance, which added to our revenues; and (iii) *Smiles* Shopping, a platform through which clients can use miles to acquire not only air tickets, but also approximately 300,000 new product and service options distributed through several partners. In 2013, we launched (i) *Clube Smiles*, a new benefits club, whereby, for a R$30.00 monthly fee, members receive 1,000 miles a month plus a one-year extension to their miles expiration date as well as other benefits, such as early access to *Smiles* promotions; (ii) option to purchase and reactivate miles; (iii) option to transfer miles; and (iv) a partnership with PayPal, allowing *Smiles* clients to exchange miles accumulated in the program for a pre-paid virtual card that can be used as payment for purchases made with all PayPal partners.

- *Partnerships*. Existing and new partnerships with large international airlines, in the form of code-share arrangements, financial institutions, retail chain-stores, car rental and insurance companies, among others, are offered to the *Smiles* loyalty program members with more opportunities to earn and redeem miles.

Expand Our Airline Partnerships. We believe we have the best platform to expand our customer base in the markets in which we operate through partnerships. We intend to strengthen our existing airline partnerships and build new ones with large international airlines in the form of code-share arrangements to further increase our international feeder network, load factor and profitability.

On December 7, 2011, we entered into a long-term commercial agreement with Delta which purpose was to strengthen the operational cooperation and synergies between us. Approximately 20% of Delta passengers are connected on our flights in Brazil. We have also a strategic maintenance, repair and operations, or MRO, partnership agreement with Delta TechOps, the maintenance division of Delta. Delta TechOps is also assisting us with our efforts to secure Federal Aviation Administration, or FAA, certification for our maintenance center. We assist Delta with certain line maintenance services for Delta aircraft with extended ground time in Brazil. In January 2013, we entered into a maintenance agreement with MTU Maintainance Hannover GmbH and MTU Maintainance Zhuhai Co., Ltd., jointly MTU, in order to provide MRO services to the remaining 50% of our CFM 56-7 engines as well as maintenance of engine parts and components of our Boeing 737 NG aircraft.

On February 19, 2014, we entered into an exclusive long term strategic partnership for commercial cooperation with Air France-KLM, which is currently under review by the Brazilian Antitrust Authority, or CADE. Under this agreement, Air France-KLM will make a payment of US$48.0 million for the purpose of enhancing our codesharing, connectivity and joint sale activities as well as other benefits for our customers, including the integration and improvement of products and services for our frequent flyer programs. As part of this agreement, Air France-KLM will also invest US$52.0 million in the acquisition of a number of our newly issued preferred shares, equivalent to 1.5% of our capital stock, at an issuance price equivalent to US$12.23 per share. The agreement further provides for the creation of an alliance committee, comprised of at least one representative of Air France-KLM, at least two members of our board of directors and at least one representative of Delta.

As of December 31, 2013, we had 76 interline agreements and 6 code-share agreements with: Delta Airlines, Iberia, KLM, Air France, Qatar Airways and Alitalia. In addition, we celebrated code-share and frequent flyer program agreements with Aerolíneas Argentinas. The code-share agreement was authorized with no restrictions by ANAC on November 26, 2013, and by the Brazilian Antitrust Authority (CADE) on January 16, 2014, and is expected to be operational by the second quarter of 2014. On April 11, 2014, we entered into a codeshare and frequent flyer program agreements with TAP. These agreements have not yet been approved by ANAC or CADE as well as by Portuguese government regulatory bodies.

Further Innovate, Establish and Increase Our Ancillary Revenue Businesses. Our ancillary revenues are derived from *Gollog*, ticket change fees, excess baggage charges and other services. We expect further growth in these businesses, which will provide us with additional revenue at low incremental cost by:

- *Focusing on express delivery services.* Through *Gollog*, our cargo transportation service, we make efficient use of extra capacity in our aircraft by carrying cargo. With a comprehensive service portfolio, express delivery accounted for approximately 25% of our cargo revenue in 2013.

- *Continuously innovating and introducing new businesses to the Brazilian market.* We have a strong track record of innovation and introduction of new business practices in Brazil. For example, in June 2009, we introduced the sale of beverages and food on board (buy on board) in Brazil, generating ancillary revenue without increasing our cost structure or fare price. As of December 31, 2013, we offered buy on board service on approximately 70% of our flights. In addition, in 2013, we introduced the sale of the new *Gol+Conforto* seats (additional legroom, recline and rows in which the middle seat is blocked), which are available free of charge for Smiles Diamond and Delta Air Lines Elite customers, and to other customers for an additional fee, as part of our *Gol+* product. *Gol+Conforto* seats are currently available in the Rio-São Paulo route and should be expanded to other routes during the course of 2014. We estimate 80% of our fleet will be configured at the *Gol+* standard by May 2014. Expanding *Gol+* from our shuttle routes to our entire flight network is part of our standardization process, which will generate revenue and increase efficiency gains.

Airline Business

Routes and Schedules

Our operating model is a highly integrated, multiple-hub route network that is different from the point-to-point model used by other low-cost carriers worldwide. The high level of integration of flights at selected airports permits us to offer frequent, non-stop flights at low fares between Brazil's most important economic centers and ample interconnections through our network linking city pairs through a combination of two or more flights with little connecting or stop-over time. Our network also allows us to increase our load factor on our strongest city pair routes by using the airports in those cities to connect our customers to their final destinations. This strategy increases our load factor by attracting customers traveling to secondary markets who prefer to pay lower fares even if this means making one or more stops before reaching their final destination. Approximately 40% of our passengers connect or fly through one or more destinations before reaching their final travel destination. Our operating model allows us to build our flight routes to add destinations to cities that would not, individually, be economically viable to serve in the traditional point-to-point model, but that are feasible to serve when simply added as additional points on our multiple-stop route network. We do this by offering low-fare, off-peak, minimum stay or night (red-eye) flights to lower-traffic destinations, which can be the first or last stops on our routes, allowing us to increase our aircraft utilization and generate additional revenues. By offering international flights to destinations in South America, the United States and the Caribbean (using our current Boeing 737 aircraft), with stops integrated in our network, we create opportunities for incremental traffic, feeding our network and increasing our overall load factor and our competitive advantage and supporting our strategy of expanding our network and stimulating demand for our services.

We have been adding more routes to Caribbean and Unites States destinations, which we expect will give us additional growth opportunities in the Brazilian and international markets. In addition, we consider expanding to potential new destinations in Latin America in regions with medium density, represented by airports with a population of up to one million within a 200 km radius.

As of March 2014, we offered over 910 daily flights to 65 destinations connecting the most important cities in Brazil as well as the main destinations in Argentina, Bolivia, Paraguay, Uruguay, the United States, Venezuela and the Caribbean region. Also, we will resume flights to Santiago, in Chile, in July, 2014, after we obtain all applicable authorizations.

Services

Passenger Transportation

We recognize that we must offer excellent services to our corporate and leisure customers. We pay particular attention to the details that help to make for a pleasant, complication-free flying experience, including:

- ticketless travel;
- convenient online sales, check-in, seat assignment and flight change and cancellation services;
- high frequency of flights between Brazil’s most important airports;
- low cancellation and high on time performance rates of our flights;
- high punctuality rates on our flights;
- online flight status service;
- web-enabled cell phone ticket sales and check-in;
- self check-in at kiosks at designated airports;
- designated female lavatories;
- friendly and efficient in-flight service;
- modern aircraft interiors;
- quick turnaround times at airport gates;
- free or discounted shuttle services between airports and drop-off zones on certain routes;
- buy on board services on certain flights;
- mobile check-in and boarding pass (100% paperless boarding);
- smartphone application for check-in, electronic boarding pass and *Smiles* account management; and

- More space between seats and greater comfort (*Gol*+ product).

In general, flight revenues, passenger demand and profitability reach peak levels during the January and July vacation periods and in the final two weeks of December, during the Christmas holiday season. Conversely, we often witness a decrease in load factor during the week in which annual carnival celebrations take place in Brazil. Given our high proportion of fixed costs, this seasonality is likely to cause our results of operations to vary from quarter to quarter.

The World Cup in 2014 may affect our load factor at specific dates and times. On the one hand, we have developed a schedule that will help us identify critical peaks in the number of passengers on certain dates in specific cities and we anticipate significant flight revenues from such peaks. On the other hand, the World Cup celebrations will reduce the number of business passengers (high value-added customers) throughout the months of June and July, which could affect revenues from flights during the relevant period.

Ancillary Revenues and Gollog Cargo Transportation

Ancillary revenues include revenues from our *Gollog* services as well as baggage excess and ticket change fees. Buy on board and travel insurance fees are also becoming an increasingly important part of this revenue. Further development and growth of our *Gollog* services is a key part of our strategy to increase ancillary revenue.

We are constantly evaluating opportunities to generate additional ancillary revenue such as sales of travel insurance, marketing activities and other services which may help us to better capitalize on the large number of passengers on our flights and the high volumes of customers using our website.

We have an integrated *Smiles* and *Gollog* platform in our air travel portal for the convenience of our customers.

We make efficient use of extra capacity in our aircraft by carrying cargo, through *Gollog*. *Gollog's* success is the result of the unique service we offer to the market: the Electronic Air Waybill that can be completed online. The *Gollog* system provides online access to air waybills and allows customers to track their shipment from any computer with Internet access. Our 65 destinations throughout Brazil, South America, the United States and the Caribbean provide access to multiple locations in each region. With our capacity of approximately 910 daily flights, operated by 137 Boeing 737-700/800 aircraft, in addition to a fleet of approximately 400 vehicles, we can guarantee quick and reliable delivery.

Our express delivery products – *Gollog* VOO CERTO, *Gollog* EXPRESS, *Gollog* ECOMMERCE and *Gollog* DOC – were developed to meet the growing demand for door-to-door deliveries, defined deadlines and additional optional services. We intend to intensify our efforts in the express delivery services by further strengthening our logistics capability, mainly by expanding our ground distribution network and further intensifying our commercial efforts.

Aircraft Fleet

On December 31, 2013, we had an operational fleet of 141 aircraft, of which four were in redelivery process, and a total fleet of 150 aircraft.

The following table sets forth the composition of our fleet at the dates indicated:

		At December 31,	
Operating Fleet	**Seats**	**2012**	**2013**
B737-700 NG	144	37	36
B737-800 NG	186	17	17
B737-800 NG Short-Field Performance	186	72	88
Sub Total	–	**126**	**141**(1)

		At December 31,	
Non-Operating Fleet	**Seats**	**2012**	**2013**
B737-300(2)	141	19	8
B767-300/200	218	3	1
Sub Total	**–**	**22**	**9**
Total	–	**148**	**150**

(1) 4 aircraft are not operational as they are in the process of being returned under their respective leases.

(2) All B737-300 aircraft result from the acquisition of Webjet. See “—Non-operating Fleet” below.

As of December 31, 2013, of our total 150 aircraft: 99 were under operating leases, 46 were under finance leases and five were owned by us.

As of December 31, 2013, our operating leases had an average remaining term of 122 months and original total terms of up to 144 months from the date of delivery of the relevant aircraft.

As of December 31, 2013, our finance leases had an average remaining term of 112 months and we had purchase options for 40 of our aircraft under finance leases.

We believe that leasing our aircraft fleet provides us with flexibility to adjust our fleet size. We make monthly rental payments, some of which are based on floating rates, but we are not required to make termination payments at the end of our leases. Under our operating lease agreements, we do not have purchase options and for some of our lease agreements we are required to maintain maintenance reserve deposits and to return the aircraft and engine in the agreed condition at the end of the lease term. Title to the aircraft remains with the lessor. We are responsible for the maintenance, servicing, insurance, repair and overhaul of the aircraft during the term of the lease.

In line with our strategy of combining the renovation of our fleet with disciplined growth in our seat supply, in 2013, we received 15 aircraft based on operating lease contracts and one aircraft based on a finance lease contract. We returned three aircraft under operating leases and no aircraft under finance lease contracts.

Operating Fleet

The average age of our operating fleet of 137 Boeing 737-700/800 aircraft as of December 31, 2013, was 7.1 years. The average daily utilization rate of our operating fleet in 2013 was 11.2 block hours as compared to 12.1 block hours in 2012.

Each Boeing 737 aircraft in our fleet is powered by two CFM International Model CFM 56-7B22 engines or two CFM International Model CFM 56-7B24 engines. All Boeing 737-800 NG Short-Field Performance are equipped with an upgrade thrust plug in each engine, which allows it to operate as a CFM 56-7B27/B3 engine with 27,000 lbs.

The Boeing 737-700 Next Generation and Boeing 737-800 Next Generation aircraft currently comprising our fleet are fuel-efficient and very reliable. They suit our cost efficient operations well for the following reasons:

- they have comparatively standardized maintenance routines;
- they require just one type of standardized training for our crews;
- they use an average of 7% less fuel than other aircraft of comparable size, according to Boeing; and
- they have one of the lowest operating costs in their class.

In addition to being cost-efficient, the Boeing 737-700/800 Next Generation aircraft are equipped with advanced technology that promotes flight stability, providing a more comfortable flying experience for our customers. We use a single type of aircraft to preserve the simplicity of our operations and the introduction of any new aircraft type to our fleet will only be done if, after careful consideration, we determine that such a step will reduce our operating costs. As such, we plan to continue keeping our operating fleet exclusively comprised of Boeing 737-700/800 aircraft, until the arrival of our newly ordered Boeing 737 Max-7/8 aircraft (the newest generation of our current aircraft) which we expect will be delivered starting 2018.

Most of our Boeing 737-800 Next Generation aircraft are equipped with blended winglets and all Boeing 737-800 Next Generation aircraft from our purchase order will be equipped with winglets, which reduce our fuel and maintenance costs. Our experience with the new winglets has shown operating fuel consumption reductions from 3% to 5%. In addition, the winglets improve airplane performance during take-off and landing on short runways. The new Boeing 737-800 NG aircraft will be delivered with short-field performance (SFP) with technical modifications that we expect to significantly improve flight performance, the ability to operate non-stop flights, reduce noise during take-off and enable us to fly with our Boeing 737-800 Next Generation aircraft to the airport of Santos Dumont in Rio de Janeiro, an important link to the most important routes in Brazil.

In 2011, we announced the delivery of the first Next Generation 737-800 equipped with the new Sky Interior standard and since then all our new aircraft are equipped with this standard.

Non-operating Fleet

As of December 31, 2013, we had a non-operating fleet composed of eight B737-300 aircraft, resulting from the acquisition of Webjet, and one B767-300. In addition, as of December 31, 2013, four aircraft from our operating fleet were in redelivery process.

Two of the B767-300 aircraft were transferred to Delta Airlines. The third B767-300 aircraft is grounded and its lease agreement expires in December 2014.

Fleet Plan

The following table sets forth our year-end projected operating fleet through 2018:

Projected Operating Fleet Plan	**2014**	**2015**	**2016**	**2017**	**2018**
B737-700/800 NG*	137	140	140	141	141

* Includes SFP aircraft (Short Field Performance)

The fleet plan includes the arrival of new Boeing 737-MAX aircraft, which are expected to arrive in 2018. We will revise this fleet plan according to our expectations for the growth potential in the markets in which we operate.

Sales and Distribution

Our customers can purchase tickets directly from us through a number of different channels, such as our website including our Booking Web Services (BWS), our call center, at airport ticket counters and, to a lesser extent, GDS.

Our low-cost low-fare business model utilizes website ticket sales as its main distribution channel, especially in the local market. For the year ended December 31, 2013, 87.6% of our passenger revenues, whether directly from the customer or through travel agents, were booked online, making us a global leader in this area. In the same period, 4.9% of our passenger revenues were booked through call centers, airport sales counters, and our BWS and 7.5% of our total sales were made through the GDS.

Our customers can purchase tickets indirectly through travel agents, who are a widely-used travel service resource in Brazil and South America, Europe, North America and other regions. For the year ended December 31, 2013, travel agents provide us with approximately 11,000 distribution outlets throughout these regions.

GDS allows us access to a large number of tourism professionals who are able to sell our tickets to customers throughout the globe and enables us to enter into interline agreements with other airlines to offer more flights and connection options to our passengers and add incremental international passenger traffic, especially to our international network.

In December 2013, we reformulated our sales website in order to make online purchases easier and faster. Our clients can now filter searches by price, check flight status and register travel companions as favorites. Additionally, clients who purchase their flights online less than 7 days before departure will have their check-in done automatically.

Partnerships and Alliances

General

Our strong market positioning enables us to successfully negotiate a number of arranged partnerships with supplementary major carriers worldwide, mostly in the form of code-share agreements and interline agreements. Additional passenger inflows generated by these strategic partnerships help improve revenues at low incremental costs.

At December 31, 2013, we had code-share agreements with Delta Airlines, Iberia, KLM, Air France, Qatar Airways and Alitalia. The *Smiles* loyalty program is linked to the various frequent flyer programs of our code-share partners, enabling travelers to accrue and redeem miles between the programs, however, the partnerships are not integrated among themselves. In addition, passengers of our partner airlines are able to connect to Gol-operated flights within Brazil, marketed as a code-share partner flight. We intend to enter into similar agreements with other long haul airlines serving or intending to serve Brazil.

As of December 31, 2013, we had 76 interline agreements and 6 code-share agreements with: Delta Airlines, Iberia, KLM, Air France, Qatar Airways and Alitalia. In addition, we celebrated code-share and frequent flyer program agreements with Aerolíneas Argentinas. The code-share agreement was authorized with no restrictions by ANAC on November 26, 2013, and by CADE on January 16, 2014, and is expected to be operational by the second quarter of 2014. On April 11, 2014, we entered into codeshare and frequent flyer program agreements with TAP. These agreements were not yet approved by ANAC or CADE as well as by competent Portuguese government regulatory bodies.

An interline agreement is a commercial agreement between individual airlines to handle passengers traveling on itineraries that require multiple airlines. This type of agreement allows passengers to utilize a single ticket and to check their baggage through to the passengers' final destination. Interline agreements differ from code-share agreements in that code-share agreements usually refer to numbering a flight with the airline's code (abbreviation) even though the flight is operated by another airline. These agreements provide for better marketing and customer recognition of the links between the airlines.

In February 2011, we entered into a strategic MRO partnership agreement with Delta TechOps, the maintenance division of Delta, which provides overhaul service for approximately 50% of our CFM 56-7 engines, maintenance for parts and components on our fleet of Boeing 737NG aircraft and also consulting services related to maintenance workflow planning, materials and facility optimization and tooling support. Delta TechOps also assists us with our efforts to secure FAA certification. In addition, we will assist Delta with certain line maintenance services for Delta aircraft with extended ground time in Brazil.

In January 2013, we entered into a Maintenance Agreement with MTU in order to provide MRO services to the remaining 50% of our CFM 56-7 engines as well as maintenance of engine parts and components of our Boeing 737 NG aircraft.

On February 19, 2014, we entered into an exclusive long term strategic partnership for commercial cooperation with Air France-KLM, which is currently under review by the Brazilian Antitrust Authority, or CADE.

Under this agreement, Air France-KLM make a payment of US$48.0 million for the purpose of enhancing our codesharing, connectivity and joint sale activities as well as other benefits for our customers, including the integration and improvement of products and services for our frequent flyer programs. As part of this agreement, Air France-KLM will also invest US$52.0 million in the acquisition of a number of our newly issued preferred shares, equivalent to 1.5% of our capital stock, at an issuance price equivalent to US$12.23 per share.

The agreement further provides for the creation of an alliance committee, comprised of at least one representative of Air France-KLM, at least two members of our board of directors and at least one representative of Delta.

An important element of our business strategy is to cater to the corporate client. To further develop our business relationship with our corporate customers, we have entered into partnerships with hotel chains, rental car agencies and insurance providers to offer our corporate customers the convenience of the combination of transportation and accommodation arrangements.

Delta Investment and Commercial Agreements

On December 7, 2011 our controlling shareholder and Delta entered into an investment agreement providing for the sale of 8,300,455 preferred shares in the form of ADSs owned by our controlling shareholder to Delta at a price per share equivalent to R$22.00, or the Delta Investment. Our controlling shareholder used the entire net proceeds from the sale of preferred shares to Delta to subscribe for new common and preferred shares in a rights offering issued by us at the same price per share paid by Delta.

Our controlling shareholder further agreed to elect a Delta representative to our board of directors as long as Delta holds at least 50% of the ADSs acquired in the investment, among other conditions.

In the context of the Delta Investment, we entered into a long-term commercial agreement with Delta that included exclusivity provisions designed to strengthen the operational cooperation and synergies between the two companies, including:

- an increase in the scope of the code-share agreement (flight sharing). We have our own code in all Delta flights between Brazil and the United States. In addition, Delta continues to increase the use of codeshare in our flights in Brazil, South America, the United States and the Caribbean. This increases the number of flight options for passengers of both airlines, expanding our geographical reach. We estimate that approximately 20% of Delta passengers are connected on our flights in Brazil;

- optimization of flight connections and cargo and passenger transport services through the operations working group among the nearly 400 destinations in over 62 countries served by Gol and Delta;

- the increase in passenger comfort by aligning services and benefits for members of both the *Smiles* and SkyMiles mileage programs, for example, making it possible to earn and redeem miles and get free access to *GOL+Conforto* seats, among other advantages;

- joint commercial and promotional activities, encouraging both airlines' sales forces to cooperate in Brazil, the United States and other countries, including joint sponsorship of events such as Rock in Rio; and

- the exploration of synergies in passenger services, maintenance, VIP lounges and logistical support, including Delta task force in revenue management and maintenance, the use of *Smiles* lounge by Delta Elite passengers and the use of the SkyClub by *Smiles* Diamond passengers.

Pricing

Brazilian airlines are permitted to establish their own domestic fares without previous government approval. Airlines are free to offer price discounts or follow other promotion activities. Airlines must submit, 30 days after the end of each month, a file containing fares sold and quantity of passengers for each fare amount, for all markets. This file lists regular fares and excludes all contracted, corporate and private fares. The objective is to monitor the average market prices. The same procedure applies for international fares. The only difference is that all fares sold for interline itineraries are also excluded from the file sent to ANAC.

Yield Management

Yield management involves the use of historical data and statistical forecasting models to produce knowledge about our markets and guidance on how to compete to maximize our operating revenues. Yield management forms the backbone of our revenue generation strategy and is strongly linked to our route and schedule planning and our sales and distribution methods. Our yield management practices enable us to react quickly in response to market changes. For example, our yield management systems are instrumental in helping us to identify the flight times and routes for which we offer promotions. By offering lower fares for seats that our yield management indicates would otherwise remain unsold, we capture additional revenue and also stimulate customer demand.

Maintenance

According to ANAC regulation, we are directly responsible for the execution and control of all maintenance services performed on our aircraft. The maintenance performed on our aircraft can be divided into two general categories: line and heavy maintenance. Line maintenance consists of routine, scheduled maintenance checks on our aircraft, including pre-flight, daily and overnight checks and any diagnostics and routine repairs. All of our line maintenance is performed by our own highly experienced technicians at our line maintenance service bases throughout Brazil and South America. We believe that our practice of performing daily preventative maintenance helps to maintain a high aircraft utilization rate and reduces maintenance costs. Heavy maintenance consists of more complex inspections and servicing of the aircraft that cannot be accomplished overnight. Heavy maintenance checks are performed following a pre-scheduled agenda of major overhauls defined by the aircraft's manufacturer, based on the number of hours and flights flown by the aircraft. In addition, engine maintenance services are rendered in different MRO facilities. We do not believe that our high aircraft utilization rate will necessarily result in the need to make more frequent repairs to our aircraft, given the durability of the aircraft type in our fleet. Our aircraft are covered by warranties that have an average term of 48 months for products and parts and 12 years for structural components. The warranties on the aircraft we received in 2012 under our firm purchase order with Boeing will start expiring in 2016.

We internalized heavy maintenance on our Boeing 737 aircraft in our Aircraft Maintenance Center at the Tancredo Neves International Airport in Confins, in the State of Minas Gerais. We use this facility for airframe heavy checks, line maintenance, aircraft painting and aircraft interior refurbishment. We have three hangars at our Aircraft Maintenance Center, with a capacity to perform maintenance on 6 aircraft simultaneously and painting services on one additional aircraft. We also have room to build another hangar, if needed.

With our system of phased maintenance for our Boeing Next Generation 737-700 and 737-800 aircraft fleet, we are able to perform maintenance work every day without sacrificing aircraft revenue time and to schedule preventive maintenance with more regularity and around the utilization of our aircraft, which helps to maintain high levels of block hours per day and reduces costs.

We have entered into two strategic MRO partnership agreements in order to provide overhaul service for our CFM 56-7 engines, maintenance for parts and components on our fleet of Boeing 737 NG aircraft and also, consulting services related to maintenance workflow planning, materials and facility optimization and tooling support:

- with Delta TechOps, the maintenance division of Delta, for maintenance of 50% CFM 56-7 engines. Delta TechOps will also assist us with our efforts to secure FAA certification. This agreement also provides for our rendering of maintenance services to Delta aircraft with extended ground time in Brazil.

- with MTU in order to provide MRO services to the remaining 50% of our CFM 56-7 engines as well as maintenance of engine parts and components of our Boeing 737 NG aircraft.

We have been certified by ANAC under Brazilian Aeronautical Certification Regulations to perform heavy maintenance services for third parties. We have used this certification as a source for ancillary revenues, since our construction of an additional maintenance facility was completed.

Fuel and Hedge

Our fuel costs totaled R$3,610.8 million in 2013, representing 41.6% of our operating expenses for the year. In 2013, we purchased substantially all of our fuel from Petrobras Distribuidora, a retail subsidiary of Petrobras, principally under an into-plane contract under which the supplier supplies fuel and also fills our aircraft tanks. In 2013, fuel prices under our contracts were re-set every 30 days and were composed of a variable and a fixed component. The variable component is defined by the refinery and follows international crude oil price fluctuations and the *real*/U.S. dollar exchange rate. The fixed component is a spread charged by the supplier and is usually a fixed cost per liter during the term of the contract. We currently operate a tankering program under which we fill the fuel tanks of our aircraft in regions where fuel prices are lower. We also provide our pilots with training in fuel management techniques, such as carefully selecting flight altitudes to optimize fuel efficiency.

Fuel costs are extremely volatile, as they are subject to many global economic and geopolitical factors that we can neither control nor accurately predict. Because international prices for jet fuel are denominated in U.S. dollars, our fuel costs, though payable in *reais*, are subject not only to price fluctuations but also to exchange rate fluctuations. We maintain a fuel hedging program, based upon policies which define volume, price targets and instruments, under which we enter into fuel and currency hedging agreements with various counterparties providing for price protection in connection with the purchase of fuel. Our hedging positions cover short and long-term periods, and are adjusted weekly or more frequently as conditions require. Our hedging practices are executed by our internal risk management committee and overseen by the risk policies committee of our board of directors. The risk policies committee of our board of directors meets monthly or more often, if called, and its main responsibilities are to assess the effectiveness of our hedging policies, recommend amendments when and where appropriate and establish its views regarding fuel price trends. We use risk management instruments that have a high correlation with the underlying assets so as to reduce our exposure. We require that all of our risk management instruments be liquid so as to allow us to make position adjustments and have prices that are widely disclosed. We also avoid concentration of credit and product risk. We have not otherwise entered into arrangements to guarantee our supply of fuel and we cannot provide assurance that our hedging program is sufficient to protect us against significant increases in the price of fuel.

As of December 31, 2013, we had hedged 12% on average for our projected fuel requirements for 2014. We also have an interest hedge program and we have hedged 73% of the leases for aircraft to be delivered in 2014 and 2015. The fuel hedge is based on call options, swap and collar contracts, and the interest hedge is based on forward swap contracts.

The following chart summarizes our fuel consumption and costs for the periods indicated:

	Year Ended December 31,	
	2012	**2013**
Liters consumed (in thousands)	1,655,421	1,511,869
Total cost (in thousands)	R$3,742,219	R$3,610,822
Average price per liter	R$2.26	R$2.39
% change in price per liter	18.0%	5.7%
Percent of operating expenses	41.5%	41.6%

We continuously invest in initiatives to reduce fuel consumption. We started using Aircraft Communications Addressing and Reporting System, or ACARS, in 2010. ACARS is a system that permits real-time digital transmission, via satellite, of important flight data between aircraft and our bases, allowing routes and flight times to be automatically updated. We decided to increase ACARS coverage and create the CCD (Digital Communications Center) within the Operational Control area, which started operating in May 2011. We had installed ACARS in 135 aircraft by the end of 2013. The Center is responsible for monitoring aircraft in real time, as well as streamlining operations and managing various flight data. We also started using GPS Landing System in January 2010 and we expect to have the system implemented in all our fleet by the end of 2014. This system reduces fuel consumption during take-off and landing, increases precision and safety.

Safety and Security

Our most important priority is the safety of our passengers and employees. We maintain our aircraft in strict accordance with manufacturer specifications and all applicable safety regulations, and perform routine line maintenance every day. Our pilots have extensive experience, with flight captains having more than 10,000 hours of career flight time, and we conduct ongoing courses, extensive flight simulation training and seminars addressing the latest developments in safety and security issues. We closely follow the standards established by ANAC's Air Accident Prevention Program and we have installed the Flight Operations Quality Assurance System, which maximizes proactive prevention of incidents through the systematic analysis of the flight data recorder system. All of our aircraft are also equipped with Maintenance Operations Quality Assurance, a troubleshooting program that monitors performance and aircraft engine trends. The Brazilian civil aviation market follows the highest recognized safety standards in the world. We are also an active member of the Flight Safety Foundation, a foundation for the exchange of information about flight safety.

Environmental Sustainability

Since 2010, we prepare Annual Sustainability Reports based on Global Reporting Initiative (GRI) guidelines, an international standard for reporting economic, social and environmental performance. By adopting these parameters, we are reinforcing our accountability with various stakeholders through added transparency and credibility.

We also constantly invest in becoming more environmentally sustainable and have recently implemented the following actions:

- Expansion of our Aircraft Maintenance Center at the Tancredo Neves International Airport located in Confins, in the State of Minas Gerais: we have reduced costs by decreasing the necessity of flying our aircraft overseas to be serviced. We also treat all of the effluents generated in our facilities and are committed to the reuse of water. The Maintenance Center was designed to comply with environmental responsibility requirements and all of the conditions imposed by the environmental licenses and current legislation.

- We were the first Brazilian airline selected to join the Sustainable Aviation Fuel Users Group (SAFUG), an international aviation biofuel research group, and we participate in biofuel feasibility tests. On October 23, 2013, we flew the first commercial flight with biofuel in Brazil, from Congonhas to Brasília, which emitted approximately 0.5 tons less CO_2.

- We have a partnership agreement with the Fuel and Carbon Services Division of GE Aviation, which envisages the creation of studies and systems to reduce fossil fuel consumption and greenhouse gas emissions.

Insurance

We maintain passenger liability insurance in an amount consistent with industry practice and we insure our aircraft against losses and damages on an "all risks" basis. We have obtained all insurance coverage required by the terms of our leasing agreements. We believe our insurance coverage is consistent with airline industry standards in Brazil and is appropriate to protect us from material loss in light of the activities we conduct. No assurance can be given, however, that the amount of insurance we carry will be sufficient to protect us from material loss.

Competition

Domestic

Airlines in Brazil compete primarily on the basis of routes, fare levels, frequency of flights, capacity, airport operating rights and presence, reliability of services, brand recognition, frequent flyer programs and customer service.

Our main competitors in Brazil are the recently-formed LATAM Airlines Group, or LATAM, Azul Linhas Aéreas, or Azul, and Avianca Brasil, or Avianca. LATAM is the result of a June 2012 merger between TAM Airlines of Brazil and LAN Airlines of Chile, and is a full-service scheduled carrier offering flights on domestic routes and international routes. Azul is a low-cost regional domestic carrier, which acquired another regional carrier, Trip, on May 28, 2012. Avianca was founded in 1919 in Colombia, and licensed its brand in Brazil in 2010. We also face domestic competition from other domestic scheduled carriers, regional airlines and charter airlines, which mainly have regional networks.

As the growth in the Brazilian airline sector evolves, we may face increased competition from our primary competitors and charter airlines as well as other entrants into the market that reduce their fares to attract new passengers in some of our markets.

The following table sets forth the historical market shares on domestic routes, based on revenue passenger kilometers, of the significant airlines in Brazil for each of the periods indicated:

Domestic Market Share— Scheduled Airlines	**2009**	**2010**	**2011**	**2012**	**2013**
Gol	41.7%	39.5%	37.4%	38.7%	35.4%
Webjet[(1)]	4.4%	5.9%	5.5%	-	-
LATAM[(2)]	45.4%	42.8%	41.1%	40.8%	39.9%
Azul[(3)]	3.7%	6.1%	8.6%	10.1%	17.0%
Trip[(3)]	1.5%	2.2%	3.2%	4.5%	-
Avianca	2.5%	2.6%	3.1%	5.4%	7.1%
Others	0.8%	1.0%	0.9%	0.7%	0.6%

Source: ANAC

(1) On October 3, 2011, we acquired Webjet.

(2) Known as TAM Airlines prior to its June 2012 merger with LAN Airlines of Chile.

(3) In May 2012, Azul acquired TRIP.

Until 2010, parking, landing and navigation fees charged in Brazilian airports were similar in all airports independent of whether they were busy or not. From 2011 until February 2012, the Brazilian government increased parking fees at the busiest airports, as compared to less busy airports, and at peak hours, which benefitted secondary hubs and off-peak flights in light of the differences in fees for the airlines that chose to operate in these airports or at these times. Currently, landing fees are fixed, based on the category of the airport and whether the flight is domestic or international. Navigation fees are also fixed, but consider the area overflown and whether the flight is domestic or international.

Domestically, we also face competition from ground transportation alternatives, primarily interstate bus companies. Given the absence of meaningful passenger rail services in Brazil, travel by bus has traditionally been the only low-cost option for long-distance travel for a significant portion of Brazil's population. We believe that our low-cost business model has given us flexibility in setting our fares to stimulate demand for air travel among passengers who in the past have traveled long distances primarily by bus. In particular, the highly competitive fares we have offered for travel on our night flights, which have often been comparable to bus fares for the same destinations, have had the effect of providing direct competition for interstate bus companies on these routes.

The Brazilian federal government has for some time been seeking to expand regional flights within Brazil. On April 10, 2014, the SAC contacted Brazilian airlines to discuss the possibility of government subsidies in return for increased regional flights. The SAC asked airlines to evaluate the operational feasibility and costs of beginning or increasing service to certain regional airports. Based on these responses, the SAC will assist the federal government in evaluating the advisability of subsidized regional flights. There is no indication at this point of the terms, timing or manner of implementing such a program, if at all. We are thus unable to evaluate the effect this program could have on us, our competition and the industry in Brazil.

International

As we expand our international services in South America, the United States and the Caribbean, our pool of competitors will increase and we will face competition from Brazilian, United States and South American airlines that are already established in the international market and that participate in strategic alliances and code-share arrangements. In addition, non-Brazilian airlines may decide to enter or increase their schedules in the market for routes between Brazil and other South American, United States and Caribbean destinations. Also, we will resume flights to Santiago, in Chile, in July, 2014, after we obtain all applicable authorizations.

In 2010, ANAC approved the deregulation of international airfares for flights departing from Brazil to the United States and Europe, gradually removing the prior minimum fares. In addition, in 2010, the National Civil Aviation Council (*Conselho de Aviação Civil*), or CONAC, approved the continuity of bilateral agreements providing for open skies policies with other South American countries and a new open skies policy with the United States. The agreement with the United States is expected to be in operation by 2015; it was already approved by the United States Government and Brazilian Legislature. A similar agreement with Europe is still in early stages. These new regulations should increase the number of passengers in South America and grow our market. To the extent that our presence and/or the presence of our partner, Delta, increase in the South American market, this will contribute even more to our business. On the other hand, to the extent competition increases in the expanded South American market and we and/or Delta loose significant market share, we may be adversely affected.

Smiles Loyalty Program

Segregation of the Smiles Loyalty Program

On December 21, 2012, we approved the segregation of the activities related to the *Smiles* loyalty program, or the *Smiles* loyalty program, previously managed by us, and which began to be conducted by Smiles. On May 2, 2013, Smiles concluded its IPO in which it issued a number of common shares equivalent to 43% of its total capital for R$1.1 billion. The proceeds of this IPO were used for the purchase by Smiles of advanced tickets from us at a conditional discount rate equivalent to between 140% and 150% of the Interbank Deposit Certificate (*Certificados de Depósito Interbancário*), or CDI rate, which corresponded to a 12.49% per year discount.

General Atlantic Investment Agreement

On April 5, 2013, we entered into an investment agreement with General Atlantic Service Company LLC., or General Atlantic, providing for an investment by General Atlantic in Smiles. Under this agreement, G.A. Smiles Participações S.A., or G.A. Smiles, an affiliate of General Atlantic, purchased in the IPO a number of Smiles common shares equivalent to R$400.0 million, or 15.8% of Smiles total capital.

In connection with G.A. Smiles' investment, on April 23, 2013, we entered into a shareholders agreement granting G.A. Smiles the right to appoint one member of Smiles' board of directors and certain veto rights regarding: amendments to the Operational Agreement or the Miles and Tickets Purchase Agreement, which set the terms and conditions for our relationship with Smiles, certain related party transactions in excess of R$2.0 million, and certain advance ticket purchases.

In April 2013, we granted G.A. Smiles an option, exercisable within 12 months of the IPO (as of May 2, 2013), to purchase from us an additional number of Smiles common shares equivalent to 20% of G.A. Smiles' initial investment, at the same price per share set in the IPO as adjusted by the CDI rate. On February 27, 2014, General Atlantic exercised this option and purchased a total amount of 3,443,476 common shares, or 2.8% of Smiles' total capital stock, for approximately R$80 million. As a result of General Atlantic's exercise of the purchase option, we currently hold 54.5% of Smiles total capital as opposed to 57.3% held prior to General Atlantic's exercise.

Merger of G.A. Smiles Participações S.A. into Smiles

On December 31, 2013, G.A. Smiles Participações S.A., or G.A. Smiles, merged into Smiles. The equity interest previously held by G.A. Smiles on *Smiles* was transferred to G.A. Smiles' sole shareholder, G.A. Brasil Fundo do Investimento em Participações. The tax goodwill previously registered under G.A. Smiles was merged into Smiles and should be amortized for tax deduction purposes under Brazilian law.

Overview

Smiles is one of the largest coalition loyalty programs in Brazil, with over 9.7 million members as of December 31, 2013. Its business model is based on developing a coalition loyalty program consisting of a single platform for accumulating and redeeming miles through a broad network of commercial and financial partners.

The *Smiles* loyalty program was originally launched by Varig in 1994 as a frequent flyer program and was acquired by us in 2007, together with other assets of the Varig business. Beginning in 2008, the *Smiles* loyalty program, which had been essentially inactive for years, underwent a complete restructuring and revitalization. In 2010, we continued with the *Smiles* loyalty program restructuring and, since then, the program has gained significant market share. The *Smiles* loyalty program has been transformed from a stand-alone program to a coalition loyalty program.

Currently, *Smiles* loyalty program allows members to accumulate miles through: (1) flights with us and our international partners, (2) the main Brazilian commercial banks, including through co-branded credit cards issued by Bradesco and Banco do Brasil, (3) a broad network of 215 retail partners, including Petrobras Distribuidora, the largest fuel distributor in Brazil, among others, (4) actually purchasing miles and (5) purchases of miles and benefits from *Clube Smiles*. We are Smiles' primary redemption partner but members may also redeem miles to purchase products and services from commercial partners.

The agreements that govern our commercial relationship with Smiles allow unrestricted access to seats on our flights.

Products and Services

Smiles' main business is the sale of miles. Its commercial partners purchase miles to distribute to *Smiles* loyalty program members when members purchase products or services from these partners. Members accumulate miles, which are redeemed in exchange for rewards, which in turn are acquired from commercial partners.

Smiles earns revenue mainly by (1) selling miles to its commercial partners and (2) providing loyalty program management services to commercial partners, including our loyalty program.

To become eligible to earn miles, individuals enroll in the *Smiles* loyalty program through its website. Members have a single account for accumulating and redeeming miles, and are not required to transfer miles or pay additional redemption fees.

A *Smiles* loyalty program account permits members to accumulate miles by purchasing products or using services offered by any of its commercial partners. Members may redeem and convert their miles into travel or non-travel rewards. Our current policy is to cancel all miles in member accounts when they expire, which varies from three to five years.

In addition to selling miles, Smiles manages our loyalty program and intends to expand its loyalty program management services to its other commercial partners.

Miles Redemption

Travel rewards represented the majority of redemptions as of December 31, 2013. However, with the option of redeeming miles through *Smiles* Shopping, a platform through which redemption commercial partners offer a variety of reward products, we expect that the proportion of reward redemptions for products other than airline travel will increase.

Miles Sales to Members and Smiles and Money

Smiles was the first Brazilian loyalty program to sell miles to members to allow them to add miles to their account balances in order to facilitate redemption of higher value rewards. Currently, members may purchase miles through its website. Miles purchases are automatically credited to member accounts and can later be used for reward tickets or rewards through *Smiles* Shopping.

Smiles and Money allows members to redeem rewards using a combination of miles and money. We believe that *Smiles and Money* and miles sales encourages member engagement, as it expands access to rewards.

Commercial Partners

As of the date of this annual report, the Smiles network of commercial partners is composed of approximately 215 companies, including more than 120 partners from which members may earn miles and 30 partners from which members may redeem rewards. Its partners span various industries and include airlines, financial institutions, travel agencies, hotels, car rental companies, food and non-food retailers, gas stations, bookstores, car manufacturers, real estate developers, media companies, drugstores, restaurants and parking lot operators, among others.

• *Airlines*. We are the single most important commercial partner in terms of miles and rewards volumes. We purchase miles from Smiles to distribute to our passengers. Additionally, Smiles has agreements with our airline partners, which are currently Delta Airlines, Iberia, KLM, Air France, Qatar Airways and Alitalia.

• *Financial Institutions*. Smiles has commercial partnership agreements with 22 Brazilian and international financial institutions, including the five largest Brazilian commercial banks in terms of total assets as of December 31, 2013, according to the Central Bank. Smiles sells miles to these commercial partners, which distribute them proportionately to credit card spending by cardholders who are *Smiles* loyalty program members. Smiles also sells miles for co-branded credit cards issued by Bradesco and Banco do Brasil.

• *Travel Companies, Hotels and Car Rental Agencies*. Currently, Smiles has over 40 commercial partnership agreements with well-known domestic and international travel companies, hotels and car rental companies. These partners include Hilton HHonors Worldwide LLC, Marriott International, Starwood Hotels and Resorts Worldwide Inc, Othon Hotels, Sheraton Hotels, Atlântica Hotels International (Brasil) Ltda, and Sauípe S.A. (a tourism complex in Brazil). This network allows *Smiles* loyalty program members to accumulate miles at a variety of locations worldwide and throughout the course of their travels.

• *Brazilian Retailers and Distributors*. Smiles has commercial agreements with over 40 important Brazilian retailers, including Petrobras Distribuidora (a fuel distributor), Polishop (a domestic electronics and merchandise retailer), the newspapers Jornal o Globo and Jornal Valor Econômico, B2W – Companhia Global do Varejo (Brazil's largest e-commerce company), Editora Abril S.A. (one of the largest Brazilian publishing companies), Editora Três (of Brazilian ISTOÉ magazine), Ri Happy (a toy manufacturing chain), Centauro (a sports clothing and equipment retail chain) and Walmart.com.

Competition

Smiles faces the following types of competition in Brazil: (i) frequent flyer programs, (ii) the loyalty programs of financial institutions and similar entities and (iii) other loyalty programs in general. The first group includes Multiplus, the current market leader, and other players such as the Tudo Azul program and Avianca's Programa Amigo. The second group includes a variety of large financial institutions and similar entities that have their own loyalty programs, such as the SuperBônus Program of Banco Santander (Brasil) S.A., the Bradesco Loyalty Card Program of Banco Bradesco S.A., the Sempre Presente Program of Banco Itaú Unibanco S.A. and the American Express Membership Rewards Program. The majority of these programs allow members to transfer accumulated reward points to programs like the *Smiles* loyalty program. The third group of competitors includes companies such as Dotz, among others.

There is currently no publicly available data on the loyalty industry in Brazil. However, information disclosed by Multiplus suggests that they have approximately a 74% market share and Smiles has a 26% market share, excluding other smaller industry players.

If foreign loyalty programs such as Aeroplan or Air Miles enter the Brazilian market, Smiles may face additional competition. However, entry of foreign loyalty programs would also present new opportunities for commercial partnerships.

Agreements with Smiles

Operating Agreement

On December 28, 2012, we entered into an operating agreement with Smiles, or the Operating Agreement, that establishes the terms and conditions of our relationship. This agreement went into effect on January 1, 2013, when Smiles began to manage and operate the *Smiles* loyalty program.

The Operating Agreement established the terms of the transfer of *Smiles* loyalty program management to Smiles. In the context of the transfer, we divided reward costs as follows: the cost of rewards redeemed with legacy miles (i.e., those earned through December 31, 2012) is supported by us, while the cost of rewards redeemed with new miles (i.e., those earned beginning January 1, 2013) is supported by Smiles.

Pursuant to the Operating Agreement, the Smiles program will be our sole loyalty program. We are currently Smiles' sole partner in the air transportation industry, but Smiles is free to establish new partnerships in this industry with our prior authorization. We may require Smiles to enter into a partnership agreement with new partners in the air transportation industry or with a global alliance of airlines in the event we become a party to one.

We have a preference to enter into partnerships in certain segments, such as travel agencies (including on-line travel agencies), rental cars and travel insurance. However, Smiles may establish partnerships in these industries with our prior authorization.

Outside of the air transportation industry and certain segments in the travel industry, Smiles does not need to inform or request our authorization to establish partnerships. We may establish partnerships outside the air transportation industry as long as such partnerships do not involve miles or benefits accumulation in a frequent flyer program other than the *Smiles* loyalty program.

The 20-year Operating Agreement will be automatically renewed for successive five-year periods if neither party objects at least two years prior to its expiration. If a party is given notice of non-renewal, it may terminate the Operating Agreement early by providing written notification to the other party six months prior to the termination date.

We pay Smiles a monthly fee for managing our frequent flyer program. This fee will be adjusted on each anniversary of the Operating Agreement in accordance with our gross monthly miles purchases. For 2013, the management fee was 6.0% of gross miles sales. After 2013, this fee will remain between 3.5% and 6.0%, depending on our gross miles purchases.

Miles and Tickets Purchase Agreement

On December 28, 2012, we entered into a miles and tickets purchase agreement with Smiles, or the Miles and Tickets Purchase Agreement, that establishes the terms and conditions of our purchases of miles and our sales of tickets.

In order to govern pricing and availability of reward tickets and satisfy customer demand, the agreement establishes three seating classes: standard, commercial and promotional for ticketing purposes.

- *Standard seats*: Pricing will take into account the variation of the economic cost of the fare over the last 12 months and the characteristics of each route. The economic cost is equivalent to the sum of (i) the opportunity cost of not selling a ticket to a traveler when the flight is full – or displacement; (ii) the opportunity cost of a passenger redeeming a reward ticket who would have purchased the ticket using cash, had he or she not had available miles – or dilution; and (iii) the direct cost that we incur in transporting an additional passenger on a given flight – or marginal cost. The availability of standard seating on planes is limited and controlled by us, although Smiles is assured a minimum aggregate number of standard seats out of total seats on all flights.
- *Commercial seats*: Pricing is subject to the same price and/or discount applied by us to third parties (subject to the conditions and characteristics of each product). The availability of commercial seats on flights is unrestricted, but limited to the capacity of the flight, pursuant to applicable restrictions.
- *Promotional seats*: Pricing is determined by an established discount table agreed upon by us and Smiles on a case-by-case basis, which may be revised, suspended or revoked at any time at our discretion. There is no minimum availability obligation for promotional seats.

The price that we pay for miles will be calculated based on the economic cost specified above, minus a portion of the breakage rate, which is the expected percentage of miles that will expire without being redeemed.

Pursuant to the Miles and Tickets Purchase Agreement, any material change to our miles accumulation policy must be discussed in advance by a loyalty committee whose members will be appointed by Smiles and us, proportionally. Smiles must notify us of material changes to miles redemption policy relating to reward tickets and hold discussions of such changes in the loyalty committee. The loyalty committee will be an advisory committee with no decision-making power.

Smiles may sell miles directly to its clients, subject to certain limits on miles sold per client and per period, minimum prices and the length of redemption periods.

The 20-year Miles and Tickets Purchase Agreement will be automatically renewed for successive five-year periods if neither party objects at least two years prior to its expiration. If a party is given notice of non-renewal, it may terminate the agreement early by providing written notification to the other party six months prior to the termination date.

The parties will annually review the contract's compliance conditions according to certain parameters established in the agreement, and may amend these conditions in order to reestablish the originally agreed-upon economic balance. In extraordinary circumstances, the parties may also amend the agreement in the event of significant changes to (i) the economic cost of flights (including changes in the average occupancy rate of our flights or ticket prices); (ii) our destinations; or (iii) applicable law or regulation.

Back Office Services Agreement

On December 28, 2012, we entered into a back office services agreement with Smiles, or the Back Office Services Agreement, that contains the terms, conditions and levels of certain services to be provided to Smiles by us. These services will be provided in connection with certain back office activities including controllership, accounting, internal controls and auditing, finance, information technology, call center, human resources, inventory and legal matters.

The three-year Back Office Services Agreement will be automatically renewed for successive three-year periods if neither party objects 12 months prior to its expiration. Smiles may terminate portions of the Back Office Services Agreement at any time by providing prior written notice to us.

Corporate Governance

On June 10, 2013, Smiles' by-laws were amended to provide that certain related party transactions will require the approval of an independent committee or all members of its board of directors. These related party transactions include: amendments to the Operational Agreement or the Miles and Tickets Purchase Agreement and certain advance ticket purchases, among other transactions.

Industry Overview

According to the International Civil Aviation Organization, or ICAO, Brazil is the third largest domestic aviation market in the world and, according to ANAC, there were 92 million domestic enplanements and 19 million international enplanements on Brazilian carriers in Brazil in 2013, out of a total population of over 200 million, according to the Brazilian Institute of Geography and Statistics (*Instituto Brasileiro de Geografia e Estatística*), or IBGE. In contrast, according to the U.S. Department of Transportation, the United States had 654 million domestic enplanements and 83 million international enplanements in 2012, out of a total population of over 317 million, based on the latest United States census estimates.

The business travel segment is the largest component of Brazilian air transportation demand and the most profitable in the market. According to company data, business travel represented around 60% of the total demand for domestic air travel in 2013, which we believe is significantly higher than the business travel portion of domestic air travel in the global aviation sector. According to the latest data collected by ANAC, flights between Rio de Janeiro and São Paulo accounted for 4.5% of all domestic passengers in 2013. The ten busiest routes accounted for 13.9% of all domestic air passengers in 2013, while the ten busiest airports accounted for 41.5% and 39.1% of all domestic passenger traffic through INFRAERO airports in terms of arrivals and departures in 2013 and 2012, respectively.

In light of economic growth, the consumer domestic market (A, B and C classes) has significantly increased in the last years. According to ANAC, there were 92 million domestic passengers in 2013 versus 90 million in 2012. Due to increased passenger volume, in addition to the upcoming World Cup (2014) and Summer Olympic Games (2016) in Brazil, domestic airport infrastructure will require substantial improvements.

In 2009, CONAC proposed to the Brazilian government a change to the regulatory limit of foreign ownership in Brazilian airline companies from 20% to 49% or higher. Since 2009, there have been no updates to this process and we are unable to anticipate if and when there will be a final decision on the matter.

In August 2011, the Brazilian government privatized the new Natal airport, which construction is on the verge of completion. In February 2012, the Brazilian government privatized the Guarulhos, Brasília and Campinas international airports, which will be operated by the winners of the privatization auction for periods of 20 to 30 years. In November 2013, the Brazilian government privatized Galeão (Rio de Janeiro) and Confins (Belo Horizonte) airports. Other airports are also expected to be privatized in the near future.

Brazilian Civil Aviation Market Evolution

Since 1970, Brazil has for the most part experienced stable growth in revenue passenger kilometers. From 1970 to 2009, domestic revenue passenger kilometers grew at a compound annual rate of 8.9%. In the past 40 years, the domestic market generally experienced year-over-year growth in revenue passenger kilometers except in times of significant economic or political distress, such as the petroleum crisis in the 1970s, the Brazilian sovereign debt crisis in the early 1980s and the economic and political distress in Brazil in the early 1990s.

From 2009 to 2013, the compound annual growth rate in industry passenger traffic, in terms of domestic revenue passenger kilometers, was 9.2%, versus a compound annual growth rate in available industry domestic capacity, in terms of available seat kilometers, of 6.0%. Domestic industry load factor, calculated as revenue passenger kilometers divided by available seat kilometers, averaged 70.8% over the same period. The table below shows the figures of domestic industry passenger traffic and available capacity for the periods indicated:

	2009	2010	2011	2012	2013
		(in millions, except percentages)			
Available Seat Kilometers	86,471	102,643	116,080	119,337	115,886
Available Seat Kilometers Growth	18.7%	18.9%	13.1%	2.8%	-2.9%
Revenue Passenger Kilometers	56,864	70,306	81,452	87,047	88,226
Revenue Passenger Kilometers Growth	18.9%	23.6%	16.0%	6.9%	1.4%
Load Factor	65.8%	68.8%	70.2%	72.9%	76.1%

Source: *ANAC, Dados Comparativos Avançados.*

In 2010, Brazil was the third largest market in domestic revenue passenger kilometers and according to ANAC, in 2011, the Brazilian aviation industry showed the strongest market growth in the world. According to IATA, global domestic air travel markets expanded 4.9% in 2013 in terms of RPK, led by China and Russia.

The 2013 traffic figures reflect the industry's current trend of controlling domestic supply through the main airlines, in response to the new cost level, as well as the sluggish growth of Brazil's economy.

Regulation of the Brazilian Civil Aviation Market

The Brazilian Aviation Authorities and Regulation Overview

Air transportation services are considered a public service and are subject to extensive regulation and monitoring by CONAC and ANAC. Air transportation services are also regulated by the Brazilian Federal Constitution and the Brazilian Aeronautical Code. The Brazilian civil air transportation system is controlled by several authorities. ANAC is responsible for the regulation of the airlines; and the Department of Air Space Control (*Departamento de Controle do Espaço Aéreo*), or DECEA, is responsible for airspace control.

The following chart illustrates the main regulatory bodies, their responsibilities and reporting lines within the Brazilian governmental structure.

In March 2011, the Civil Aviation Secretary (*Secretaria de Aviação Civil*), or SAC, was created to supervise civil aviation in Brazil. SAC oversees ANAC and INFRAERO and reports directly to the Brazilian President. SAC is also responsible for implementation of the airport infrastructure concession plan and the development of strategic planning for civil aviation.

In August 2011, the National Commission of Airport Authorities (*Comissão Nacional de Autoridades Aeroportuárias*), or CONAERO, was created as a commission of SAC to coordinate the different entities and public agencies related to airports. This commission shall have a normative role in the search for efficiency and security in airports operations.

CONAERO is composed by the following individuals and representatives of entities: (i) SAC, which chairs the commission; (ii) the Brazilian president's chief of staff; (iii) Agriculture, Livestock and Supplies Ministry; (iv) Defense Ministry; (v) Finance Ministry; (vi) Justice Ministry; (vii) Planning, Budget and Administration Ministry; (viii) Health Ministry; and (ix) ANAC.

ANAC is currently responsible for guiding, planning, stimulating and supporting the activities of public and private civil aviation companies in Brazil. ANAC also regulates flying operations and economic issues affecting air transportation, including matters relating to air safety, certification and fitness, insurance, consumer protection and competitive practices.

The DECEA reports indirectly to the Brazilian Minister of Defense which is responsible for planning, administrating and controlling activities related to airspace, aeronautical telecommunications and technology. This includes approving and overseeing the implementation of equipment as well as of navigation, meteorological and radar systems. The DECEA also controls and supervises the Brazilian Airspace Control System.

With respect to non-privatized airports, INFRAERO, a state-controlled corporation reporting to SAC, is in charge of managing, operating and controlling federal airports, including some control towers and airport safety operations. With respect to the recently privatized airports (Natal, Galeão, Confins, Guarulhos, Viracopos and Brasília), although INFRAERO still holds a minority stake in each of them, INFRAERO is no longer in charge of operations, which are now handled by their respective private operators. See "Regulation of the Brazilian Civil Aviation Market–Airport Infrastructure" below.

CONAC is an advisory body of the President of Brazil and its upper level advisory board is composed of the Minister of Defense, the Minister of Foreign Affairs, the Minister of Treasury, the Minister of Development, Industry and International Trade, the Minister of Tourism, the Brazilian president's chief of staff, the Minister of Planning, Budget and Management, the Minister of Justice, the Minister of Transportation and the Commandant of the Air Force. CONAC has the authority to establish national civil aviation policies that may be adopted and enforced by the High Command of Aeronautics and by ANAC. CONAC establishes guidelines relating to the proper representation of Brazil in conventions, treaties and other actions related to international air transportation, airport infrastructure, the granting of supplemental funds to be used for the benefit of airlines and airports based on strategic, economic or tourism-related aspects, the coordination of civil aviation, air safety, the granting of air routes and concessions, as well as permission for the provision of commercial air transportation services.

The Brazilian Aeronautical Code sets forth the main rules and regulations relating to airport infrastructure and operation, flight safety and protection, airline certification, lease structuring, burdening, disposal, registration and licensing of aircraft; crew training, concessions, inspection and control of airlines, public and private air carrier services, civil liability of airlines and penalties in case of infringements.

In February 2009, the Brazilian government approved the new Civil Aviation National Policy (*Política Nacional de Aviação Civil*), or PNAC. Although the PNAC does not establish any immediate measure, it contains the main guidelines for the national civil aviation system. It encourages the Ministry of Defense, CONAC and ANAC to issue regulations on strategic matters such as safety, competition, environmental and consumer issues, as well as to inspect, review and evaluate the activities of all operating companies.

The Brazilian government recognized and ratified, and must comply with, the Warsaw Convention of 1929, the Chicago Convention of 1944 and the Geneva Convention of 1948, the three leading international conventions relating to worldwide commercial air transportation activities.

Route Rights

Domestic routes. For the granting of new routes and changes to existing ones, ANAC evaluates the actual capacity of the airport infrastructure where such route is or would be operated. In addition, route frequencies are granted subject to the condition that they are operated on a frequent basis. Any airline's route frequency rights may be terminated if the airline (a) fails to begin operation of a given route for a period exceeding 15 days, (b) fails to maintain at least 75% of flights provided for in its air transportation schedule (*Horário de Transporte Aéreo*), or HOTRAN, for any 90-day period or (c) suspends its operation for a period exceeding 30 days. ANAC approval of new routes or changes to existing routes is given in the course of an administrative procedure and requires no changes to existing concession agreements.

Once routes are granted, they must be immediately reflected in the HOTRAN, which is the official schedule report of all routes that an airline can operate. The HOTRAN provides not only for the routes but also the times of arrival at and departure from certain airports, none of which may be changed without the prior consent of ANAC. According to Brazilian laws and regulations, an airline cannot sell, assign or transfer its routes to another airline.

International routes. In general, requests for new international routes, or changes to existing routes, must be filed by each interested Brazilian airline that has been previously qualified by ANAC to provide international services, with the International Relations Superintendence of ANAC, or SRI, which, based on the provisions of the applicable bilateral agreement and general policies of the Brazilian aviation authorities, will submit a non-binding recommendation to ANAC's president, who will decide on approval of the request. International route rights for all countries, as well as the corresponding transit rights, derive from bilateral air transport agreements negotiated between Brazil and foreign governments. Under such agreements, each government grants to the other the right to designate one or more of its domestic airlines to operate scheduled service between certain destinations in each country. Airlines are only entitled to apply for new international routes when they are made available under these agreements. For the granting of new routes and changes to existing ones, ANAC has the authority to approve Brazilian airlines to operate new routes, subject to the airline having filed studies satisfactory to ANAC demonstrating the technical and financial viability of such routes and fulfilling certain conditions in respect of the concession for such routes. Any airline's international route frequency rights may be terminated if the airline fails to maintain at least 80% of flights provided for in its air transportation schedule HOTRAN for any 180-day period or suspends its operation for a period exceeding 180 days.

In 2010, ANAC approved the deregulation of international airfares for flights departing from Brazil to the United States and Europe, gradually removing the prior minimum fares. In addition, in 2010, CONAC approved the continuity of bilateral agreements providing for open skies policies with other South American countries and a new open skies policy with the United States. The agreement with the United States is expected to be in operation by 2015; it was already approved by the United States Government and Brazilian Legislature. A similar agreement with Europe is still in early stages. These new regulations should increase the number of passengers in South America and grow our market. To the extent that our presence and/or the presence of our partner, Delta, increase in the South American market, this will contribute even more to our business. On the other hand, to the extent competition increases in the expanded South American market and we and/or Delta loose significant market share, we may be adversely affected.

Slots Policy

Domestic. Under Brazilian law, a domestic slot concession derives from a flight concession by ANAC, which is reflected in the airline's HOTRAN. Each HOTRAN represents the authorization for an airline to depart from and arrive at specific airports within a predetermined timeframe. Such period of time is known as an "airport slot" and provides that an airline can operate at the specific airport at the times established in the HOTRAN. An airline must request an additional slot from ANAC with a minimum of two months' prior notice.

Congonhas airport in the city of São Paulo is a "coordinated" airport, where slots must be allocated to an airline company before it may begin operations there. Although it is difficult to obtain a slot in Congonhas airport, on March 8, 2010, ANAC reallocated 202 idle Congonhas' slots. The Santos-Dumont airport in Rio de Janeiro, a highly utilized airport with half-hourly shuttle flights between São Paulo and Rio de Janeiro, also presents certain slot restrictions. ANAC has imposed schedule restrictions on several Brazilian airports from which we operate. Operating restrictions, including the prohibition of international flights' operations and the prohibition of civil aircraft's operation after 11:00 p.m. and before 6:00 a.m., were imposed for Congonhas airport (São Paulo), one of the busiest Brazilian airports and the most important airport for our operations. No assurance can be given that these or other government measures will not have a material adverse effect on us.

CONAC has taken certain measures to minimize recent technical and operational problems at São Paulo's airports, including the redistribution of air traffic from Congonhas airport (São Paulo) to the international airport in Guarulhos. CONAC has also mentioned its intention to adjust tariffs for the use of busy airport hubs to encourage further redistribution of air traffic.

In February 2013, ANAC announced a series of public hearings to discuss the allocation of slots in Brazilian airports. This regulation governs the manner of allocation of slots, by organizing rotations among the concessionaires, determining the procedures for registration, qualification, judgment and homologation of a request for slot concessions in coordinated airports and transfer of slots between concessionaires. Rules governing the allocation of slots in Brazilian airports would consider operational efficiency (punctuality and regularity) as the main determinant for the allocation of slots.

Also in February 2013, the Civil Aviation Secretary, or SAC, announced a new proposal focused specifically on slot distribution rules at Congonhas airport (São Paulo). SAC's proposal would alter current regulation and takes into account operational efficiency as a principal determinant for slot allocation at Congonhas airport, as well as domestic market (main cities) and regional market share as complementary factors.

Discussions among Brazilian regulators are currently being held at ANAC to address the increase in capacity at the airport and the percentage of additional slots that should be assigned preferably to new entrants. The remaining slots will be allocated among other airline companies already in operation at Congonhas, including us.

Airport Infrastructure

INFRAERO, a state-controlled corporation, is in charge of managing, operating and controlling federal airports, including some control towers and airport safety operations.

Smaller, regional airports may belong to states or municipalities within Brazil and, in such cases, are often managed by local governmental entities. At most important Brazilian airports, INFRAERO performs safety and security activities, including passenger and baggage screening, cargo security measures and airport security.

The use of areas within federal airports, such as hangars and check-in counters, is subject to a concession by INFRAERO. If there is more than one applicant for the use of a specific airport area, INFRAERO may conduct a public bidding process for the granting of the concession. For recently privatized airports (Natal, Galeão, Confins, Guarulhos, Viracopos and Brasília), operators may freely negotiate all commercial areas according to their own criteria; there is no requirement that a public bidding must be held in the event there is more than one applicant for the use of a specific airport area.

We have renewable concessions with terms varying from one to five years from INFRAERO to use and operate all of our facilities at each of the major airports that we serve. Our concession agreements for our terminals' passenger service facilities, which include check-in counters and ticket offices, operations support areas and baggage service offices, contain provisions for periodic adjustments of the lease rates and the extension of the concession term.

Of the 63 Brazilian airports managed by INFRAERO at the end of 2013, approximately 30 were receiving infrastructure investments and upgrades. The airport upgrade plan does not require contributions or investments by the Brazilian airlines and is not expected to be accompanied by increases in landing fees or passenger taxes on air travel.

Until 2010, parking, landing and navigation fees charged in Brazilian airports were similar in all airports independent of whether they were busy or not. From 2011 until February 2012, the Brazilian government increased parking fees at the busiest airports, as compared to less busy airports, and at peak hours, which benefitted secondary hubs and off-peak flights in light of the differences in fees for the airlines that chose to operate in these airports or at these times. Currently, landing fees are fixed, based on the category of the airport and whether the flight is domestic or international. Navigation fees are also fixed, but consider the area overflown and whether the flight is domestic or international.

In August 2011, the Brazilian government privatized the new Natal airport, which construction is on the verge of completion. In February 2012, the Brazilian government privatized the Guarulhos, Brasília and Campinas international airports, which will be operated by the winners of the privatization auction for periods of 20 to 30 years. In November 2013, the Brazilian government privatized Galeão (Rio de Janeiro) and Confins (Belo Horizonte) airports. Other airports are also expected to be privatized in the near future.

The airports auctioned were:

	Cumbica (Guarulhos)	**Viracopos (Campinas)**	**Juscelino Kubitschek (Brasília)**	**Galeão (Rio de Janeiro)**	**Confins (Belo Horizonte)**
State	São Paulo	São Paulo	Distrito Federal	Rio de Janeiro	Minas Gerais
Grant	R$ 16.2 billion	R$ 3.8 billion	R$ 4.5 billion	R$ 19 billion	R$1.8 billion
Concession term	20 Years	30 Years	25 Years	25 Years	30 Years
Minimum investment	R$ 4.7 billion	R$ 8.7 billion	R$ 4.7 billion	R$4.8 billion	R$1.1 billion
Additional fee	10% of Annual Gross Revenue	5% of Annual Gross Revenue	2% of Annual Gross Revenue	5% of Annual Gross Revenue	5% of Annual Gross Revenue

Source: SAC

Concession for Air Transportation Services

According to the Brazilian Federal Constitution, the Brazilian government is responsible for public services related to airspace, as well as airport infrastructure, and may provide these services directly or through third parties under concessions or authorizations. According to the Brazilian Aeronautical Code and regulations issued by CONAC, the application for a concession to operate regular air transportation services is subject to a license granted by ANAC to operate an airline and to explore regular air transportation services. The applicant is required by ANAC to have met certain economic, financial, technical, operational and administrative requirements in order to be granted such license. Additionally, a concession applicant must be an entity incorporated in Brazil, duly registered with the Brazilian Aeronautical Registry (*Registro Aeronáutico Brasileiro*), or RAB, must have a valid airline operating certificate (*Certificado de Homologação de Empresa de Transporte Aéreo*), or CHETA, and must also comply with certain ownership restrictions. See "—Restrictions to the Ownership of Shares Issued by Concessionaires of Air Transportation Services." ANAC has the authority to revoke a concession for failure by the airline to comply with the terms of the Brazilian Aeronautical Code, the complementary laws and regulations and the terms of the concession agreement.

Our concession was granted on January 2, 2001 by the High Command of Aeronautics of the Ministry of Defense. The concession agreement can be terminated if, among other things, we fail to meet specified service levels, cease operations or declare bankruptcy.

The Brazilian Aeronautical Code and the regulations issued by CONAC and ANAC do not expressly provide for public bidding processes and currently it is not necessary to conduct public bidding processes prior to granting of concessions for the operation of air transportation services. Due to the intense growth of the civil aviation sector, this rule may be changed by the government, in order to allow more competition or to achieve other political purposes.

Import of Aircraft into Brazil

The import of civil or commercial aircraft into Brazil is subject to prior certification of the aircraft by ANAC. Import authorizations usually follow the general procedures for import of goods into Brazil, after which the importer must request the registration of the aircraft with the RAB.

Registration of Aircraft

The registration of aircraft in Brazil is governed by the Brazilian Aeronautical Code, under which no aircraft is allowed to fly in Brazilian airspace, or land in or take off from Brazilian territory, without having been properly registered. In order to be registered and continue to be registered in Brazil, an aircraft must have a certificate of registration (*certificado de matrícula*) and a certificate of airworthiness (*certificado de aeronavegabilidade*), both of which are issued by the RAB after technical inspection of the aircraft by ANAC. A certificate of registration attributes Brazilian nationality to the aircraft and is evidence of its enrollment with the competent aviation authority. A certificate of airworthiness is generally valid for six years from the date of ANAC's inspection and authorizes the aircraft to fly in Brazilian airspace, subject to continuing compliance with certain technical requirements and conditions. The registration of any aircraft may be cancelled if it is found that the aircraft is not in compliance with the requirements for registration and, in particular, if the aircraft has failed to comply with any applicable safety requirements specified by ANAC or the Brazilian Aeronautical Code.

All information relating to the contractual status of an aircraft, including purchase and sale agreements, operating leases and mortgages, must be filed with the RAB in order to provide the public with an updated record of any amendments made to the aircraft certificate of registration.

Restrictions on the Ownership of Shares Issued by Concessionaires of Air Transportation Services

According to the Brazilian Aeronautical Code, in order to be eligible for a concession for operation of regular services, the entity operating the concession must have at least 80% of its voting stock held directly or indirectly by Brazilian citizens and must have certain management positions entrusted to Brazilian citizens. The Brazilian Aeronautical Code also imposes certain restrictions on the transfer of capital stock of concessionaires of air transportation services, such as VRG, including the following:

- the voting shares have to be nominative and non-voting shares cannot be converted into voting shares;

- prior approval of the Brazilian aviation authorities is required for any transfer of shares, regardless of the nationality of the investor, which results in the change of the company's corporate control, causes the assignee to hold more than 10% of the company's capital stock or represents more than 2% of the company's capital stock;

- the airline must file with ANAC, in the first month of each semester, a detailed shareholder chart, including a list of shareholders, as well as a list of all share transfers effected in the preceding semester; and

- based on its review of the airline's shareholder chart, ANAC has the authority to subject any further transfer of shares to its prior approval.

We hold substantially all of the shares of VRG, which are public concessionaires of air transportation services in Brazil. Under the Brazilian Aeronautical Code, the restrictions on the transfer of shares described above apply only to companies that hold concessions to provide regular air transportation services. Therefore, the restrictions do not apply to the us.

Environmental Regulation

Brazilian airlines are subject to various federal, state and municipal laws and regulations relating to the protection of the environment, including the disposal of materials and chemical substances and aircraft noise. These laws and regulations are enforced by various governmental authorities. Non-compliance with such laws and regulations may subject the violator to administrative and criminal sanctions, in addition to the obligation to repair or to pay damages caused to the environment and third parties. As far as civil liabilities are concerned, Brazilian environmental laws adopt the strict and joint liability regime. In this regard we may be liable for violations by third parties hired to dispose of our waste. Moreover, pursuant to Brazilian environmental laws and regulations, the piercing of the corporate veil of a company may occur in order to ensure enough financial resources to the recovery of damages caused against the environment.

We adopted several Environmental Management System, or EMS, procedures with our suppliers and use technical audits to enforce compliance. We exercise caution, and may reject goods and services from companies that do not meet our environmental protection parameters unless confirmation of compliance is received.

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We are monitoring and analyzing the developments regarding amendments to Kyoto protocol and emissions regulations in the United States and Europe and may be obliged to acquire carbon credits for the operation of our business. No legislation on this matter has yet been enacted in Brazil.

Pending Legislation

The Brazilian congress is currently discussing a draft bill that would replace the current Brazilian Aeronautical Code (*Código Brasileiro de Aeronáutica*). In general, this draft bill deals with matters related to civil aviation, including airport concessions, consumer protection, limitation of airlines' civil liability, compulsory insurance, fines and the increase of limits to foreign ownership in voting stock of Brazilian airlines. This draft bill is still under discussion in the House of Representatives and, if approved, must be submitted for approval to the Senate, before being sent for presidential approval. If the Brazilian civil aviation framework changes, or ANAC implements increased restrictions, the Brazilian airline industry could be negatively affected.

The Brazilian federal government has for some time been seeking to expand regional flights within Brazil. On April 10, 2014, the SAC contacted Brazilian airlines to discuss the possibility of government subsidies in return for increased regional flights. The SAC asked airlines to evaluate the operational feasibility and costs of beginning or increasing service to certain regional airports. Based on these responses, the SAC will assist the federal government in evaluating the advisability of subsidized regional flights. There is no indication at this point of the terms, timing or manner of implementing such a program, if at all. We are thus unable to evaluate the effect this program could have on us, our competition and the industry in Brazil.

Aircraft Financing by Export Credit Agencies

In addition, in 2010, the Ex-Im Bank agreed on a common approach with European export-credit agencies on offering export credits for commercial aircraft. Among other things, the new Sector Understanding on Export Credits for Civil Aircraft, or the ASU, sets forth minimum guarantee premium rates applicable to aircraft delivered on or after January 1, 2013, or under firm contracts entered into after December 31, 2010 and also changes the maximum amount that may be financed.

In light of our current credit ratings and the introduction of the ASU, our minimum guaranty premium rate applicable to aircraft delivered on or after January 1, 2013 increased substantially. As a consequence, finance leases have become significantly more expensive and we have therefore entered nearly exclusively into operating leases in 2012 and 2013.

Aircraft Repossession

The Cape Town treaty is an international treaty intended to standardize transactions involving movable property. The treaty creates international standards for registration of ownership, security interests (liens), leases and conditional sales contracts and various legal remedies for default in financing agreements, including repossession and the effect of particular states' bankruptcy laws. As of March 2014, the convention had been ratified by 60 countries. This treaty was approved by the Brazilian Legislature and is currently awaiting ratification from the President.

C. Organizational Structure

We are a holding company that directly or indirectly own shares of seven subsidiaries: (i) VRG; (ii) Webjet; (iii) Smiles; four offshore subsidiaries, (iv) Gol Finance Inc., or Gol Finance, (v) GAC Inc., or GAC, and (vi) Gol LuxCo S.A., or Gol LuxCo; and (vii) Gol Dominican Linhas Aéreas Sas., or GOLD. VRG is our operating subsidiary, under which we conduct our air transportation business. Webjet was acquired in 2011 and we announced the winding up its activities at the end of 2012. We are the majority shareholder of Smiles, which conducts the *Smiles* loyalty program. Gol Finance, GAC and Gol LuxCo are off-shore companies established for the purpose of facilitating cross-border general and aircraft financing transactions. GOLD is a company incorporated in the Dominican Republic and is currently pre-operational.

D. Property, Plant and Equipment

Our primary corporate offices are located in São Paulo. Our commercial, operations, technology, finance and administrative staff is based primarily at our headquarters. We have concessions to use other airport buildings and hangars throughout Brazil, including a part of a hangar at Congonhas airport where we perform aircraft maintenance. As of December 31, 2013, we had finance lease agreements for 46 Boeing 737s, 41 of which had a purchase option at the end of the contract term. We own a state-of-the-art Aircraft Maintenance Center in Confins, in the State of Minas Gerais. The certification of our aircraft maintenance center authorizes airframe maintenance services for Boeing 737-300s and Boeing Next Generation 737-700 and 800s. We have three hangars at our Aircraft Maintenance Center, with a capacity to perform maintenance on six aircraft simultaneously and painting services on one additional aircraft. We also have room to build more hangars, if needed. With our system of phased maintenance for our Boeing NG 737-700 and 737-800 aircraft fleet, we are able to perform maintenance work every day without sacrificing aircraft revenue time, and schedule preventive maintenance with more regularity and around the utilization of our aircraft, which further dilutes fixed costs. We use the new facility for airframe heavy checks, line maintenance, aircraft painting and aircraft interior refurbishment. See also “Item 4—Business Overview—Aircraft” and note 16 to our financial statements as of and for the year ended December 31, 2013.

ITEM 4A. Unresolved Staff Comments

None.

ITEM 5. Operating and Financial Review and Prospects

You should read this discussion in conjunction with our consolidated financial statements, related notes and other financial information included elsewhere in this annual report.

A. Operating Results

Revenues

We derive our revenues primarily from transporting passengers on our aircraft. In 2013, approximately 91% of our revenues came from passenger fares, and the remaining 9% came from ancillary revenues, principally from our cargo business, which utilizes cargo space on our passenger flights. Nearly all of our passenger and cargo revenue is denominated in *reais*. Passenger revenue, including the part of the revenue of the *Smiles* loyalty program which relates to the redemption of miles for GOL flight tickets, is recognized either when transportation is provided or when the unused ticket expires. Cargo revenue is recognized when transportation is provided. Other ancillary revenue consists primarily of ticket change fees, excess baggage charges and interest on installment sales. Passenger revenues are based upon our capacity, load factor and yield. Our capacity is measured in terms of available seat kilometers (ASK), which represents the number of seats we make available on our aircraft multiplied by the number of kilometers the seats are flown. Load factor, or the percentage of our capacity that is actually used by paying customers, is calculated by dividing revenue passenger kilometers by available seat kilometers. Yield is the average amount that one passenger pays to fly one kilometer.

The following table demonstrates our main operating performance indicators in 2012 and 2013:

	Year Ended December 31,	
	2012	**2013**
Operating Data:		

Load-factor	70.2%	69.9%
Break-even load-factor	78.0%	67.8%
Aircraft utilization (block hours per day)	12.1	11.2
Yield per passenger kilometer (cents)	19.7	23.4
Passenger revenue per available seat kilometer (cents)	13.8	16.4
Operating revenue per available seat kilometer (cents)	15.6	18.0
Number of departures	348,578	316,466
Operating aircraft at period end	126	137

Our revenues are net of ICMS and federal social contribution taxes, including *Programa de Integração Social*, or PIS, and the *Contribuição Social para o Financiamento da Seguridade Social*, or COFINS. ICMS does not apply to passenger revenues. The average rate of ICMS on cargo revenues varies by state from 0% to 19%. As a general rule, PIS and COFINS combined are imposed at rates of 3.65% of passenger revenues.

We have one of the largest e-commerce platforms in Brazil and we generate most of our revenue from ticket sales through our website.

ANAC and the aviation authorities of other countries in which we operate may influence our ability to generate revenues. In Brazil, ANAC approves the concession of flights, and consequently slots, entry of new companies, launch of new routes, increases in route frequencies and lease or acquisition of new aircraft. Our ability to grow and increase revenues is dependent on receiving approval from ANAC for new routes, increased frequencies and additional aircraft.

Operating Expenses

We seek to lower our operating expenses by operating a young and standardized fleet with a single-class of service, having one of the newest fleets in the industry, utilizing our aircraft efficiently, using and encouraging low-cost ticket sales and distribution processes. The main components of our operating expenses include aircraft fuel, aircraft rent, aircraft maintenance, sales and marketing, and salaries, wages and benefits, including provisions for our profit sharing plan.

Our aircraft fuel expenses are higher than those of low-cost airlines in the United States and Europe because production, transportation and storage of fuel in Brazil depends on expensive and underdeveloped infrastructure, especially in the north and northeast regions of the country. In addition, taxes on jet fuel are high and are passed along to us. Our aircraft fuel expenses are variable and fluctuate based on global oil prices. In 2008, the price of West Texas Intermediate crude oil, a benchmark widely used for crude oil prices that is measured in barrels and quoted in U.S. dollars, varied significantly, reaching an all-time high of US$145 per barrel in March 2008 and decreasing to US$44.60 per barrel at the end of 2008. At year-end 2009, the price per barrel was US$79.36 and increased to US$91.40 at the end of 2010. The price per barrel was US$98.83, US$91.82 and US$98.42 at year-end of 2011, 2012 and 2013, respectively. Since global oil prices are U.S. dollar-based, our aircraft fuel costs are also linked to fluctuations in the exchange rate of the *real* versus the U.S. dollar. In 2013, fuel expenses represented 41.6% of our total operating expenses, as compared to 41.5% in 2012. We currently enter into short-term arrangements to partially hedge against increases in oil prices and foreign exchange fluctuations.

Our aircraft rent expenses are in U.S. dollars and we use short-term arrangements to hedge against exchange rate exposure related to our lease payment obligations. In addition, leases for seven of our aircraft are subject to floating-rate payment obligations that are based on fluctuations in international interest rates. We currently have hedging policies in place to manage our interest rate exposure.

Our maintenance, material and repair expenses consist of light (line) and scheduled heavy (structural) maintenance of our aircraft. Line maintenance and repair expenses are charged to operating expenses as incurred. Structural maintenance for aircraft leased under finance leases is capitalized and amortized over the life of the maintenance cycle. Since the average age of our operating fleet was 7.1 years for 137 operating Boeing 737-700/800 aircraft at December 31, 2013, and most of the parts on our aircraft are under multi-year warranties, our aircraft have required a low level of maintenance and therefore we have incurred low maintenance expenses. Our aircraft are covered by warranties that have an average term of 48 months for products and parts and 12 years for structural components. The warranties on the aircraft we received in 2012 under our firm purchase order with Boeing will start expiring in 2016.

Thus, with regard to the accounting for aircraft maintenance and repair costs, our current and past results of operations may not be indicative of future results. Our Aircraft Maintenance Center in Confins, in the State of Minas Gerais, is certificated for the maintenance services for Boeing 737-300s and Boeing Next Generation 737-700 and 800s. We currently use this facility for airframe heavy checks, line maintenance, aircraft painting and aircraft interior refurbishment. We believe that we have an advantage compared to industry peers in maintenance, materials and repairs expenses due to our in-house maintenance. We believe that this advantage will continue in the foreseeable future.

Our sales and marketing expenses include commissions paid to travel agents, fees paid for our own and third-party reservation systems and agents, fees paid to credit card companies and advertising. Our distribution costs are lower than those of other airlines in Brazil on a per available seat kilometer (ASK) basis because a higher proportion of our customers purchase tickets from us directly through our website instead of through traditional distribution channels, such as ticket offices, and we have comparatively fewer sales made through higher cost global distribution systems. We generated 87.6% of our consolidated sales through our website and API systems in 2013 and 88.8% in 2012, including internet sales through travel agents. For these reasons, we believe that we have an advantage compared to industry peers in sales and marketing expenses and expect this advantage will continue in the foreseeable future.

Salaries, wages and benefits paid to our employees include annual cost of living adjustments and provisions made for our profit sharing plan.

Aircraft and traffic servicing expenses include ground handling and the cost of airport facilities. Other operating expenses consist of general and administrative expenses, purchased services, equipment rentals, passenger refreshments, communication costs, supplies and professional fees.

Webjet

On November 23, 2012, we began the process of winding up Webjet's activities and the discontinuation of its brand. The first step adopted was to cease all Webjet flights. Webjet's passengers were absorbed by us and we became responsible for all air transport and associated services for these passengers. Eleven of Webjet's Boeing 737-300 aircraft were returned in 2013. We recognized additional costs of approximately R$140 million in the fourth quarter of 2012 in connection with Webjet's wind up. As these measures represented non-recurring expenses in 2012, our operational efficiency improved in 2013.

Brazilian Economic Environment

As most of our operations are domestic, we are affected by Brazilian general economic conditions. While our growth since 2001 has been primarily driven by our expansion into new markets and increased flight frequencies, we have also been affected by macroeconomic conditions in Brazil. We believe the rate of growth in Brazil is important in determining our future growth capacity and our results of operations. Our revenue passenger kilometer in the domestic market decreased by 4.7% in 2013 following a decrease of 5.6% in 2012 (considering Webjet pro-forma data for 2011). This decrease was primarily due to a 7.4% domestic capacity reduction in the same period in response to Brazil's economic slowdown in 2012 and 2013 and to a new industry-wide cost environment in place since 2011, caused by higher fuel costs, new exchange rate levels and additional airport fees. Even in this scenario, we were able to become more efficient, focusing on established, profitable routes. Compared to 2012, our passenger revenue per available seat kilometer (PRASK) increased by 18% and, in the last quarter of 2013, the increase reached 27%, as compared to the same period in 2012, due to a combination of higher yields and a 5.1 percentage point increase in load factor.

We are materially affected by currency fluctuations. The vast majority of our revenues are denominated in *reais* while a significant part of our operating expenses are either payable in or affected by the U.S. dollar, such as our aircraft operating lease payments, related maintenance reserves and deposits, and jet fuel expenses. In 2013, approximately 55% of our operating expenses (including aircraft fuel) were denominated in, or linked to, U.S. dollars and therefore varied with the *real*/U.S. dollar exchange rate within the year. We believe that our foreign exchange and fuel hedging programs partially protect us against short-term swings in the *real*/U.S. dollar exchange rate and jet fuel prices. Overall, we believe that the combination of our revenue stream, with its correlation to movements in the *real*/U.S. dollar exchange rate, and short-term hedges on the U.S. dollar-linked portion of our expenses, will mitigate the adverse effect on our operating expenses of abrupt movements in the *real*/U.S. dollar exchange rate.

Inflation has also affected us and will likely continue to do so. In 2013, approximately 45% of our operating expenses (excluding aircraft fuel) were denominated in *reais*, and the suppliers and service providers of these expense items generally attempt to increase their prices to reflect Brazilian inflation.

The following table shows data for real GDP growth, inflation, interest rates, the U.S. dollar exchange rate and crude oil prices for and as of the periods indicated.

	December 31,		
	2011	2012	2013
Real growth in gross domestic product	2.7%	0.9%	2.3%
Inflation (IGP-M)[1]	5.1%	7.8%	5.5%
Inflation (IPCA)[2]	6.5%	5.8%	5.9%
CDI rate[3]	10.9%	6.9%	9.8%
LIBOR rate[4]	0.6%	0.3%	0.3%
Depreciation of the *real* vs. U.S. dollar	12.6%	16.7%	10.5%
Period-end exchange rate—US$1.00	R$1.876	R$2.044	R$2.343
Average exchange rate—US$1.00[5]	R$1.675	R$1.955	R$2.161
Period-end West Texas intermediate crude (per barrel)	US$98.83	US$91.82	US$98.42
Period-end Increase (decrease) in West Texas intermediate crude (per barrel)	8.1%	(7.1)%	7.2%
Average period West Texas Intermediate crude (per barrel)	US$95.11	US$94.27	US$97.97
Average period increase (decrease) in West Texas Intermediate crude (per barrel)	19.5%	(0.9)%	3.9%

Sources: Fundação Getúlio Vargas, the Central Bank and Bloomberg

(1) Inflation (IGP-M) is the general market price index measured by the Fundação Getúlio Vargas.

(2) Inflation (IPCA) is a broad consumer price index measured by the Instituto Brasileiro de Geografia e Estatística.

(3) The CDI rate is average of inter-bank overnight rates in Brazil (as of the last date of the respective period).

(4) Three-month U.S. dollar LIBOR rate as of the last date of the period. The LIBOR rate is the London inter-bank offer rate.

(5) Represents the average of the exchange rates on the last day of each month during the period.

Critical Accounting Policies

The preparation of our consolidated financial statements in conformity with IFRS requires our management to adopt accounting policies and make estimates and judgments to develop amounts reported in our consolidated financial statements and related notes. We strive to maintain a process to review the application of our accounting policies and to evaluate the appropriateness of the estimates that are required to prepare our consolidated financial statements. We believe that our estimates and judgments are reasonable; however, actual results and the timing of recognition of such amounts could differ from those estimates. In addition, estimates routinely require adjustment based on changing circumstances and the receipt of new or better information.

Critical accounting policies and estimates are those that are reflective of significant judgments and uncertainties, and potentially result in materially different outcomes under different assumptions and conditions. For a discussion of these and other accounting policies, see Note 2.2 to our consolidated financial statements.

Property, *Plant and Equipment*. Property, plant and equipment, including reusable parts, are recorded at cost and are depreciated to estimated residual values over their estimated useful lives using the straight-line method. Each component of property, plant and equipment that has a cost that is significant in relation to the overall cost of the item is depreciated separately. Aircraft and engine spares acquired on the introduction or expansion of a fleet, as well as reusable spares purchased separately, are carried as fixed assets and generally depreciated in line with the fleet to which they relate. Pre-delivery deposits refer to prepayments under the agreements with Boeing for the purchase of Boeing 737-800 Next Generation and 737-800 MAX aircraft and include interest and finance charges incurred during the manufacture of aircraft and the leasehold improvements.

Under IAS 16 "Property, Plant and Equipment," major engine overhauls including replacement spares and labor costs, are treated as a separate asset component with the cost capitalized and depreciated over the period to the next major overhaul. All other replacement spares and costs relating to maintenance of fleet assets are charged to the income statement on consumption or as incurred. Interest costs incurred on debts that fund progress payments on assets under construction, including pre-delivery deposits to acquire new aircraft, are capitalized and included as part of the cost of the assets through the earlier of the date of completion or aircraft delivery.

In estimating the useful life and expected residual values of our aircraft, we have primarily relied upon actual experience with the same or similar types of aircraft and recommendations from Boeing. Aircraft estimated useful life is based on the number of “cycles” flown (one-take-off and landing). We have made a conversion of cycles into years based on both our historical and anticipated future utilization of the aircraft. Subsequent revisions to these estimates, which can be significant, could be caused by changes to our maintenance program, changes in utilization of the aircraft (actual cycles during a given period of time), governmental regulations related to aging aircraft and changing market prices of new and used aircraft of the same or similar types. We evaluate estimates and assumptions each reporting period and, when warranted, adjust these estimates and assumptions. These adjustments are accounted for on a prospective basis through depreciation and amortization expense, as required by IFRS.

We evaluate annually whether there is an indication that our property, plant and equipment may be impaired. Factors that would indicate potential impairment may include, but are not limited to, significant decreases in the market value of the long-lived asset(s), a significant change in the long-lived asset(s) physical condition and operating or cash flow losses associated with the use of our long-lived asset(s). As of December 31, 2011, we recognized an amount of R$50.7 million of impairment of fixed assets. As of December 31, 2012 and December 31, 2013, no impairment on property, plant and equipment assets was recognized. For more details, see note 16 to our consolidated financial statements.

Lease Accounting. Aircraft lease agreements are accounted for as either operating or capital leases (finance leases). When the risks and benefits of the lease are transferred to us, as lessee, the lease is classified as a capital lease. Capital leases are accounted for as an acquisition of the asset through a financing, with the aircraft recorded as a fixed asset and a corresponding liability recorded as a debt. Capital leases are recorded based on the lesser of the fair value of the aircraft or the present value of the minimum lease payments, discounted at an implicit interest rate, when it is clearly identified in the lease agreement, or market interest rate. The aircraft is depreciated through the lesser of its useful life or the lease term. Interest expense is recognized through the effective interest rate method, based on the implicit interest rate of the lease. Lease agreements that do not transfer the risks and benefits to us are classified as operating leases. Operating lease payments are accounted for as rent and lease expense is recognized when incurred, through the straight line method.

Sale-lease back transactions that result in a subsequent operating lease have different accounting treatments depending on the fair value of the asset, the price and the cost of the sale. If the fair value of the asset is less than its carrying amount, the difference is immediately recognized as a loss. When the sale gives rise to a gain it is recognized up to the fair value, with the excess deferred and amortized throughout the term of the lease. When the sale results in a loss and the carrying amount is not greater than fair value, the loss is deferred if compensated by future lease payments. If the carrying amount is greater than fair value, it is written down to fair value and if there is still a loss it is deferred if compensated by future lease payments.

Lease accounting is critical for us because it requires an extensive analysis of the lease agreements in order to classify and measure the transactions in our financial statements and significantly impacts us. Changes in the terms of our outstanding lease agreements and the terms of future lease agreements may affect how we account for our lease transactions and our future financial position and results of operations.

Goodwill and Intangible Assets. We have allocated goodwill and intangible assets with indefinite lives acquired through business combinations for the purposes of impairment testing to the single cash-generating unit, the operating subsidiaries VRG and Smiles, since segregation of its operations. Goodwill is tested for impairment annually by comparing the carrying amount to the recoverable amount of the cash-generating unit level that has been measured on the basis of its value-in-use, by applying cash flow projections in the functional currency based on our approved business plan covering a five-year period followed by the long-term growth rate of 3.5%. The pre-tax discount rate applied to the cash flow projections is 12.44%. Considerable judgment is necessary to evaluate the impact of operating and macroeconomic changes to estimate future cash flows and to measure the recoverable amount. Assumptions in our impairment evaluations are consistent with internal projections and operating plans. Airport operating rights acquired as part of the acquisition of VRG and Webjet were capitalized at fair value at that date and are not amortized. Those rights are considered to have an indefinite useful life due to several factors and considerations, including requirements for necessary permits to operate within Brazil and limited slot availability in the most important airports in terms of traffic volume. VRG tradenames were acquired as part of the VRG acquisition and was capitalized at fair value at that date. The tradename was considered to have an indefinite useful life and was not amortized. The carrying values of the airport operating rights and tradenames are reviewed for impairment at each reporting date and are subject to impairment testing when events or changes in circumstances indicate that carrying values may not be recoverable. Costs related to the purchase or development of computer software that is separable from an item of related hardware is capitalized separately and amortized over a period not exceeding five years on a straight-line basis. The carrying value of these intangibles is reviewed for impairment if events or changes in circumstances indicate the carrying value may not be recoverable. We assess at each balance sheet date whether intangibles with indefinite useful lives are impaired using discounted cash flow analyses, which considers the creditworthiness of the issuer of the security. As of December 31, 2011, no impairment on goodwill and other intangible assets was recognized. As of December 31, 2012, we recognized an impairment of R$56.8 million on the *Varig* tradename, as evaluated under the new perspectives of its use and, therefore, the future economic benefit to be generated by it. As of December 31, 2013, we reassessed the value of the *Varig* brand in light of its possible discontinuation. This reexamination led us to write off the residual value of the asset (impairment), and, as a result, the amount of R$6.3 million was registered in “Other operating expenses.” We have also incurred in a R$10 million write-off related to software use. For further information, see Note 17 to our financial statements.

Business Combination. We have accounted for business combinations using the acquisition method. The cost of an acquisition is measured as the sum of the consideration transferred, based on the fair value on the acquisition date. Costs directly attributable to the acquisition are accounted for as expenses when incurred. The assets acquired and liabilities assumed were measured at fair value, classified and allocated according to the contractual terms, economic circumstances and relevant conditions on the acquisition date. Goodwill is measured as the excess of consideration transferred in relation to net assets acquired at fair value. If the consideration is lower than the fair value of net assets acquired, the difference should be recognized as a gain in the income statement. After initial recognition, goodwill is measured at cost less any accumulated impairment losses. On October 3, 2011, we acquired the total capital of Webjet, through our subsidiary VRG, for an adjusted price of R$43.4 million. This acquisition was accounted by the acquisition method in accordance with IFRS 3R and the gain on bargain purchase of R$88.4 million was recorded in our income statement for the year ended December 31, 2011 under other operating revenues (expenses), not taxable as it is related to a permanent difference, according to the Brazilian transition tax regime (*Regime Tributário de Transição)*, or RTT. On October 2, 2012, we completed the valuation of assets and liabilities acquired, including intangible assets, as well as the effect of deferred taxes and concluded that no further adjustments to the provisional allocation held on October 3, 2011 were needed. The gain on bargain purchase generated by the acquisition of Webjet is related to the recognition of the value of intangible assets not recorded on Webjet's financial statements, represented by rights of use of slots in the Guarulhos and Santos Dumont airports, which are two of the busiest airports in Brazil, and which value is a consequence of the significant demand growth anticipated in the next few years and our expectation for recovery of operation profitability in these airports. In the context of winding up of Webjet's operations, we have retained all of Webjet's capacity in these airports.

Derivative Financial Instruments. We account for derivative financial instruments in accordance with IAS 39. In executing our risk management program, management uses a variety of financial instruments to protect against sharp changes in market prices and to mitigate the volatility of its expenditures related to these prices. We do not hold or issue derivative financial instruments for speculative purposes.

Derivative financial instruments are initially recognized at fair value and subsequently the change in fair value is recorded in profit or loss, unless the derivative meets the strict criteria for cash flow hedge accounting.

For hedge accounting purposes, according to IAS 39, the hedge instrument is classified as: (i) a cash flow hedge when it protects against exposure to fluctuations in cash flows that are attributable to a particular risk associated with an asset or liability recognized regarding an operation that is highly likely to occur or to an exchange rate risk for an unrecognized firm commitment, and (ii) a fair value hedge when it protects from the results of a change in the fair value of a recognized liability, or a part thereof, that could be attributed to exchange risk.

At the beginning of a hedge transaction, we designate and formally document the item covered by the hedge, as well as the objective of the hedge and the risk policies strategy. Documentation includes identification of the hedge instrument, the item or transaction to be protected, the nature of the risk to be hedged and how the entity will determine the effectiveness of the hedge instrument in offsetting exposure to variations in the fair value of the item covered or the cash flows attributable to the risk covered. The foregoing is performed with a view to ensuring that such hedge instruments will be effective in offsetting the changes in fair value or cash flows, and these are quarterly appraised to determine if they really have been effective throughout the entire period for which they have been designated.

Amounts classified in equity are transferred to profit or loss each period in which the hedged transaction affects profit or loss. If the hedged item is the cost of non-financial asset, the amounts classified in equity are transferred to the initial carrying amount of the non-financial asset.

If the forecast transaction is no longer expected to occur, amounts previously recognized in equity are transferred to profit or loss. If the designation as a hedge is revoked, amounts previously recognized in equity are recognized in profit or loss.

We measure quarterly the effectiveness of the hedge instruments in offsetting changes in prices. Derivative financial instruments are effective if they offset between 80% and 125% of the changes in price of the item for which the hedge has been contracted. Any gain or loss resulting from changes in the fair value of the derivative financial instruments during the quarter in which they are not qualified for hedge accounting, as well as the ineffective portion of the instruments designated for hedge accounting, are recognized as other finance income (expenses).

Aircraft maintenance and repair costs. Our aircraft lease agreements specifically provide that we, as lessee, are responsible for maintenance of the leased aircraft and engines, and we must meet specified airframe and engine return conditions upon lease expiration. Under certain of our existing lease agreements, we pay maintenance deposits to aircraft and engine lessors that are to be applied to future maintenance events. These deposits are calculated based on a performance measure, such as flight hours or cycles, and are available for reimbursement to us upon the completion of the maintenance of the leased aircraft. If there are sufficient funds on deposit to reimburse us for our maintenance costs, such funds are returned to us. The maintenance deposits paid under our lease agreements do not transfer either the obligation to maintain the aircraft or the cost risk associated with the maintenance activities to the aircraft lessor. In addition, we maintain the right to select any third-party maintenance provider or to perform such services in-house. Therefore, we record these amounts as a deposit on our balance sheet and recognize maintenance expense when the underlying maintenance is performed, in accordance with our maintenance accounting policy. Certain of our lease agreements provide that excess deposits at the end of the lease term are not refundable to us. Such excess could occur if the amounts ultimately expended for the maintenance events were less than the amounts on deposit. Any excess amounts held by the lessor or retained by the lessor upon the expiration of the lease, which are not expected to be significant, would be recognized as additional aircraft rental expense at the time it is no longer probable that such amounts will be used for maintenance for which they were deposited. The amount of aircraft and engine maintenance deposits expected to be utilized in the next twelve months is classified in current assets.

We follow IAS 16 – "Property, Plant and Equipment" and perform the capitalization of the costs relating to engine overhauls. This practice establishes that costs on major maintenance (including replacement parts and labor) should be capitalized only when there is an extension of the estimated useful life of the engine. Such costs are capitalized and depreciated until the next stop for major maintenance. The expense recognized directly in the income statement refers to maintenance costs of other aircraft components or even maintenance of engines that do not extend their useful life.

During the quarter ended June 30, 2011 we changed the classification of maintenance deposits from a non-monetary to a monetary asset, as since 2011, transactions involving these assets occurred substantially through receipts of funds, according to renegotiations conducted with the lessors. These transactions are recognized as exchange variation expense.

In addition, certain of our lease agreements do not require maintenance deposits; instead letters of credit are issued on behalf of the lessor, which can be claimed if the aircraft maintenance does not occur as established in the review schedule. As of December 31, 2013, no letters of credit had been executed.

Our initial estimates of the maintenance expenses regarding the leases are equal to or in excess of the amounts required to be deposited. This demonstrates it is probable the amounts will be utilized for the maintenance for which they are to be deposited and the likelihood of an impairment of the balance is remote. There has been no impairment of our maintenance deposits.

A summary of activity in the Aircraft and Engine Maintenance Deposits is as follows:

	2012	2013
	(in thousands of *reais*)	
Beginning of year	358,144	327,067
Amounts paid in	149,456	108,618
Reimbursement of expense incurred	(214,491)	(70,915)
Exchange variation	33,958	47,379
End of year	**327,067**	**412,149**

Revenue Recognition. Passenger revenue is recognized when transportation is provided. Tickets sold but not yet used are recorded as advance ticket sales that represent primarily deferred revenue for tickets sold for future travel dates. We recognize a portion of advance ticket sales as revenue based on historical data relating to the percentage of tickets sold that are not going to be used prior to the expiration date ("breakage"). The balance of deferred revenue is then reviewed on a monthly basis based on actual tickets that have expired and adjusted when necessary.

Mileage Program. The obligation created by the issuance of miles is measured based on the price that the miles were sold to its airline and non-airline partners, classified by us as the fair value of the transaction. The revenue recognition on the consolidated income or loss occurs when the Smiles Program participant, after redeeming the miles and exchanging it for flight tickets, is transported.

Our policy is to cancel miles outstanding in the accounts of customers for longer than 3 years and 11 months. The associated value for mileage credits estimated to be cancelled is recognized as revenue. We calculate the expiration estimate and non-use based on historical data. Future opportunities can significantly alter customer profile and the historical patterns. Such changes may result in material changes to the deferred revenue balance, as well as revenues recognized from that program.

Share-Based Payments. We measure the fair value of equity-settled transactions with employees at the grant date using the Black & Scholes valuation model. The resulting amount, as adjusted for forfeitures, is charged to income over the period in which the options vest. At each balance sheet date before vesting, the cumulative expense is calculated; representing the extent to which the vesting period has expired and management's best estimate of the number of equity instruments that will ultimately vest. The change in cumulative expense since the previous balance sheet date is recognized in the income statement prospectively over the remaining vesting period of the instrument.

Provisions. Provisions are recognized when we have a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where we expect some or all of a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognized as a separate asset when the reimbursement is virtually certain. The expense relating to any provision is presented in profit or loss net of any reimbursement. If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as a finance cost.

Aircraft and engines return provision: in aircraft operating leases, we are contractually required to return the equipment with a predefined level of operational capability; as a result we recognize a provision based on the aircraft return costs as set forth in the agreement. The aircraft's return provisions costs are estimated based on expenditures incurred in aircraft reconfiguration (interior and exterior), license and technical certification, painting, and other costs, according to the return agreement. Engine return provisions are estimated based on an evaluation and minimum contractual conditions that the equipment should be returned to the lessor, considering not only the historical costs incurred, but also the equipment conditions at the time of the evaluation.

Deferred taxes. Deferred taxes are calculated based on tax losses, temporary differences arising on differences between tax bases and carrying amounts for financial reporting purposes of our assets and liabilities.

Even though unused tax losses and temporary differences have no expiration date in Brazil, deferred tax assets are recorded when there is evidence that future taxable profit will be available to use such tax credits. We record our deferred tax assets based on projections for future taxable profits, which considers a number of assumptions for revenue increases, for operating costs such as jet fuel prices, leasing expenses, etc. Our business plan is revised annually in order to reevaluate the amounts to be recorded as deferred tax assets.

The use of deferred taxes is a critical accounting policy for us because it requires a number of assumptions and is based on our best estimate of our projections related to future taxable profit. In addition, because the preparation of our business plan is subject to a variety of market conditions, the results of our operations may vary significantly from our projections and as such, the amounts recorded as deferred tax assets may be impacted significantly.

On December, 31, 2013, tax credits arising from tax losses carryforwards and negative social contribution basis were valued based on the reasoned expected generation of future taxable income of our parent company and its subsidiaries, subject to legal limitations.

As of December 31, 2013, we had reported approximately R$ 1.2 billion of tax loss carryforwards and negative basis of social contribution mainly as a result of the acquisition of VRG in 2007 and Webjet in 2011 and accumulated losses. Under Brazilian tax laws we may only use our tax loss carryforwards to offset taxes payable up to 30% of the taxable profit for each year. Thus, despite having a balance of tax loss carryforwards, we may have to pay higher taxes in case we reach the compensation limits for any given year that we are entitled to use under Brazilian tax laws.

Projected future taxable income on tax losses carryforwards and negative social contribution are prepared based on business plans reviewed annually and approved by our board of directors. Such projections reflect changes in the economic scenario, market changes and also decisions of our management, including the following assumptions: (i) in the long-term scenario we will keep the strategy adopted in 2013, as we have observed a stabilization in aircraft occupancy rate followed by an increase in yield, which is, however, lower than estimated long-term inflation; (ii) we continue with our ancillary revenue growth plan, such as the sale of special seats and buy on board; (iii) concerning the costs, the main change was the new level of personnel expenditure reached in 2013. Layoffs that occurred during the last two years, became the basis of the projection for a more efficient operation, contributing to manage costs; and (iv) our plans include the arrival of a new aircraft Boeing 737-MAX, announced in 2012. From 2018, the new aircraft will contribute to an even more efficient operation in terms of fuel consumption.

Results of Operations

Year 2013 Compared to Year 2012

Demand in Brazil, as measured in revenue passenger kilometers (RPK), increased by 1.4% in 2013 as compared to 2012, while capacity in Brazil, as measured by available seat kilometers (ASK), decreased by 2.9% in the same period. These figures reflect an industry-wide response to new cost levels in 2013. International demand increased by 5.1% in the same period while international supply increased by 7.4%.

During the course of 2012 and 2013, we concentrated on adapting our operations to the current macroeconomic scenario, becoming a more efficient airline by adjusting domestic capacity and focusing on established, profitable routes. In 2013, as compared to 2012, our passenger revenue per available seat kilometer (PRASK) increased by 18% and, in the last quarter of 2013, this increase reached 27% due to a combination of higher yields and a 5.1 percentage point increase in load factor.

In 2013, our total revenue passenger kilometers (RPK) and available seat kilometers (ASK) decreased by 4.7% and 4.3%, respectively, as compared to 2012, primarily in response to industry cost levels, devaluation of the *real* in relation to the U.S. dollar, the second consecutive year of record level fuel prices and further deterioration of the Brazilian macroeconomic scenario, as indicated by its low GDP growth.

In 2013, our domestic seat supply decreased by 7.4% as compared to 2012, while domestic demand decreased by 7.3% in the same period, leading to a stable load factor. Also in 2013, our international market demand and capacity increased by 26.9% and 29.9%, respectively, as compared to 2012, primarily due to the introduction of new international routes to Santo Domingo (Dominican Republic), Miami and Orlando in December, 2012.

The table below presents certain data from our results of operations for the periods indicated:

	Year Ended December 31,	
	2012	**2013**
Income Statement Data	**(in millions of *reais*)**	
Operating revenues		
Passenger	7,160.0	8,122.2
Cargo and other	943.6	834.1
Total operating revenues	**8,103.6**	**8,956.3**
Operating expenses		
Salaries, wages and benefits	(1,569.7)	(1,333.5)
Aircraft fuel	(3,742.2)	(3,610.8)
Aircraft rent	(644.0)	(699.2)
Sales and marketing	(426.6)	(516.1)
Landing fees	(559.4)	(566.5)
Aircraft and traffic servicing	(528.7)	(599.5)
Maintenance, materials and repairs	(418.0)	(460.8)
Depreciation and amortization	(519.6)	(561.0)
Other operating expenses	(600.9)	(342.9)
Total operating expenses	**(9,009.2)**	**(8,690.3)**
Loss from operations before financial income (expense)	**(905.6)**	**266.0**
Interest expense	(453.7)	(532.1)
Financial income (expense), net	(225.5)	(387.1)
Loss before income taxes and social contribution	**(1,584.8)**	**(653.2)**
Income taxes	71.9	(71.4)
Net loss	**(1,512.9)**	**(724.6)**

Operating Revenue

Operating revenue increased by 10.5%, from R$8,103.6 million in 2012 to R$8,956.2 million in 2013. On a unit basis, revenue per available seat kilometer (RASK) increased by 15.5%, from R$15.6 cents in 2012 to R$18.0 cents in 2013. This was primarily due to the increase in passenger operating revenues, partially offset by the decrease in cargo and other revenue, as described below:

	Year Ended December 31,		
Operating Revenue	**2012**	**2013**	**Chg.%**
	(in millions of *reais*, except percentages)		
Operating revenue	**8,103.6**	**8,956.2**	**10.5%**
Passenger	7,160.0	8,122.2	13.4%
Cargo and other	943.6	834.1	(11.6%)

Passenger operating revenues increased by 13.4%, from R$7,160.0 million in 2012 to R$8,122.2 million in 2013. This variation was primarily due to a 19.0% increase in yields between the periods. Consolidated passenger revenue per ASK increased by 18.5% year-over-year.

Cargo and other revenue (flight booking, excess baggage, on board sales, etc.), or "ancillary revenue," which accounted for 9% of net revenue in 2013, decreased by 11.6% from R$943.6 million in 2012 to R$834.1 million in 2013. This decrease was primarily due to the change in the fair value of the miles issued.

Operating Expenses

Operating expenses decreased 3.5%, from R$9,009.2 million in 2012 to R$8,690.2 million in 2013, primarily due to: (i) a 7.4% decrease in domestic supply and improved fuel efficiency, which together reduced our fuel expenses by 3.5%; and (ii) a decrease in other operating expenses by 42.4%, mainly due to a provision created in 2012 with respect to the winding up of Webjet's activities and sale leaseback gains in 2013.

The following table sets forth our total operating expenses for the periods indicated:

	Year Ended December 31,		
Operating Expenses	**2012**	**2013**	**Chg.%**
	(in millions of *reais*, except percentages)		
Salaries	(1,569.7)	(1,333.5)	(15.0%)
Aircraft fuel	(3,742.2)	(3,610.8)	(3.5%)
Aircraft rent	(644.0)	(699.2)	8.6%
Sales and marketing	(426.6)	(516.1)	21.0%
Landing fees	(559.4)	(566.5)	1.3%
Aircraft and traffic servicing	(528.7)	(599.5)	13.4%
Maintenance, materials and repairs	(418.0)	(460.8)	10.2%
Depreciation and amortization	(519.6)	(561.0)	8.0%
Other operating expenses	(600.9)	(342.9)	(42.9%)
Total operating expenses	**(9,009.2)**	**(8,690.2)**	**(3.5%)**

On a per unit basis, however, our operating expense per available seat kilometer (CASK) increased by 0.7% from R$17.38 cents in 2012 to R$17.51 cents in 2013, mainly due to a 4.3% reduction in total supply of available seat kilometer (ASK), which resulted in a smaller dilution of our operating expenses. Higher CASK from (i) aircraft and traffic servicing, sales and marketing, aircraft rent, depreciation and amortization and maintenance, materials and repairs was partially offset by (ii) the reduction in salaries, wages and benefits and other operating expenses. Operating expenses per available seat kilometer excluding fuel (CASK ex-fuel) increased 0.7% from R$10.16 cents in 2012 to R$10.23 cents in 2013, for the same reasons mentioned above.

The following table sets forth certain of our CASK components as a percentage of total operating expenses, for the periods indicated:

	Year Ended December 31,		
Operating Expenses per Available Seat Kilometer Breakdown	**2012**	**2013**	**Chg %**
Fuel	41.5%	41.6%	0.1%
Personnel	17.4%	15.3%	(2.1%)
Rent	7.1%	8.0%	0.9%
Maintenance	4.6%	5.3%	0.7%
Other	29.3%	29.8%	0.5%

The following table sets forth certain of our CASK components for the periods indicated:

	Year Ended December 31,		
Operating Expenses per Available Seat Kilometer	**2012**	**2013**	**Chg %**
	(in cents of *reais*, except percentages)		
Salaries	(3.03)	(2.69)	(11.2%)
Aircraft fuel	(7.22)	(7.28)	0.8%
Aircraft rent	(1.24)	(1.41)	13.5%
Sales and marketing	(0.82)	(1.04)	26.4%
Landing fees	(1.08)	(1.14)	5.8%
Aircraft and traffic servicing	(1.02)	(1.21)	18.5%
Maintenance, materials and repairs	(0.81)	(0.93)	15.2%
Depreciation and amortization	(1.00)	(1.13)	12.8%
Other operating expenses	(1.16)	(0.69)	(40.4%)
Operating expenses per available seat kilometer (CASK)	**(17.38)**	**(17.51)**	**0.7%**
CASK excluding fuel expenses	**(10.16)**	**(10.24)**	**0.7%**

Aircraft fuel expenses decreased by 3.5%, from R$3,742.2 million in 2012 to R$3,610.8 million in 2013, largely due to: (i) the reduction of 8.7% in fuel liters consumed per available seat kilometer; and (ii) the 4.6% improvement in fuel efficiency per available seat kilometer in the year-over-year comparison. These were partially offset by: (iii) the 5.7% increase in the price of jet fuel in *reais*; and (iv) the 10.5% depreciation of the *real* against the U.S. dollar. In per available seat kilometer terms, aircraft fuel costs increased by 0.8% due to a 4.3% reduction in total supply of available seat kilometer, which allowed for a lower dilution of our operating expenses.

Salaries decreased 15.0%, from R$1,569.7 million in 2012 to R$1,333.5 million in 2013, due to: (i) a 7.7% year-over-year reduction in workforce, in line with our strategy of reducing capacity in Brazil's domestic market and (ii) the inclusion of the aviation sector in the *Brasil Maior* payroll-tax exemption program as of 2013. This was partially offset by the 6.0% average salary increase for 2013. In per available seat kilometer terms, salaries, wages and benefits decreased by 11.2%, due to these same reasons.

Aircraft rent increased by 8.6%, from R$644.0 million in 2012 to R$699.2 million in 2013, due to the 10.5% depreciation of the *real* against the U.S. dollar, given that most aircraft leasing costs are denominated in U.S. dollars. In per available seat kilometer terms, aircraft rent increased by 13.5%, due to the reduction in total supply of available seat kilometers, which resulted in a smaller dilution of our operating expenses. This increase is also impacted by the reduction in our aircraft utilization rate from 12.1 block hours/day in 2012 to 11.2 block hours/day in 2013.

Sales and marketing expenses increased 21.0%, from R$426.6 million in 2012 to R$516.1 million in 2013, due to an increase in commissions paid, which reflect our increase in sales. In per available seat kilometer terms, sales and marketing expenses increased 26.4% and the difference between these two percentages is explained by the same reasons above, as well as the 4.3% reduction in total supply of available seat kilometer, which allowed for a lower dilution of these expenses.

Landing fees, which as of the end of 2012 included passenger connection fees charged by Brazilian airports, increased by 1.3%, from R$559.4 million in 2012 to R$566.5 million in 2013. This increase was mainly due to the inclusion of such passenger connection fees, which vary between R$4.00 and R$8.00 depending on the airport. Since July 2013, passenger connection fees have been charged by all Brazilian airports. In per available seat kilometer terms, landing fees increased by 5.8% due to the lower dilution of our operating expenses in the year-over-year comparison.

Aircraft and traffic servicing expenses increased by 13.4%, from R$528.7 million in 2012 to R$599.5 million in 2013, mainly due to: (i) the increase in ramp services expenses and (ii) inflation of 5.9% (IPCA). In per available seat kilometer terms, these costs increased by 18.5% in 2013, for the same reasons in the year-over-year comparison.

Maintenance, materials and repairs increased by 10.2%, from R$418.0 million in 2012 to R$460.8 million in 2013, mainly due to: (i) an increase in the number of engines removed for maintenance and repair; and (ii) the 10.5% depreciation of the *real* against the U.S. dollar, given that most maintenance expenses are denominated in U.S. dollars. In per available seat kilometer terms, maintenance, materials and repairs increased by 15.2%, and the difference is explained by the same reasons.

Depreciation and amortization expenses increased by 8.0%, from R$519.6 million in 2012 to R$561.0 million in 2013, mainly due to: (i) an additional aircraft under finance lease (45 in 2012 against 46 in 2013); (ii) expenses associated with major engine improvements during maintenance performed pursuant to our finance lease contracts and (iii) an increase in estimated reconfiguration costs associated to aircraft returns to the respective lessor. In per available seat kilometer terms, depreciation and amortization increased by 12.8%, due to the same reasons.

Other operating expenses (mainly crew travel and accommodation expenses, direct passenger expenses, equipment leasing and general and administrative expenses) decreased 42.9%, from R$600.9 million in 2012 to R$342.9 million in 2013. In 2012, this expense included a provision in the amount of R$197.0 million in connection with the winding up of Webjet's activities and asset reevaluation. In addition, we recorded R$116.7 million in gains from sale leaseback operations in 2013 (for more information about the recognition of gains with sale leaseback transactions, see note 2.2 "g" to our consolidated financial statements). In per available seat kilometer terms, other operating expenses decreased by 40.4%, due to the reasons explained above.

Net Financial Result

Our net financial expense increased by 35.3%, from R$679.2 million in 2012 to R$919.2 million in 2013, primarily as a result of the depreciation of the *real* against the U.S. dollar and the consequent increase in other financial expenses and interest on loans due, considering that most of our debt is denominated in foreign currency.

	Year Ended December 31,		
Financial Result	**2012**	**2013**	**Chg. %**
	(in millions of *reais*)		
Interest on short and long-term debt	(453.7)	(532.1)	17.3%
Exchange rate changes, net	(284.6)	(490.1)	72.2%
Derivative net results	50.3	49.6	(1.5%)
Investment funds	99.3	149.5	50.6%
Other financial expenses	(90.5)	(96.1)	6.2%
Net financial results	**(679.2)**	**(919.2)**	**35.3%**

Interest on loans increased by 17.3% from 2012 to 2013 mainly due to: (i) a 10.5% year-over-year depreciation of the *real* against the U.S. dollar (affecting 78% of our total debt as of December 31, 2013, which is denominated in foreign currency); (ii) new debt issuances (10.750% Senior Notes due 2023 issued in February 2013); and (iii) an additional aircraft under finance lease (45 in 2012 against 46 in 2013).

Exchange rate changes increased by 72.2% from 2012 to 2013 mainly due to: (i) Brazilian macroeconomic conditions; and (ii) the 14.6% period-end depreciation of the *real* against the U.S. dollar. The exchange rate volatility has a direct impact on foreign-currency-denominated financial assets and liabilities.

Investment funds increased by 50.6% from 2012 to 2013 mainly due to: (i) a 92% increase in our total cash position (cash, cash equivalents, financial investments and short and long-term restricted cash), with proceeds obtained mainly from the Smiles IPO, which were used for the advanced purchase of our tickets by Smiles, and (ii) the increase in the Brazilian SELIC rate.

In 2013, we recognized derivative financial instruments net gain of R$49.6 million. As of December 31, 2013, we had derivative positions in place to hedge approximately 19%, 15%, 7% and 6% of our estimated jet fuel consumption for the first, second, third, and fourth quarters of 2014.

Other financial expenses increased by 6.2%, from R$90.5 million in 2012 to R$96.1 million in 2013, mainly due to an expense of R$8.8 million related to waiver fees paid to holders of our Debentures IV and V.

Income Tax

Income tax moved from a credit of R$71.9 million in 2012 to an expense of R$71.4 million in 2013 due to the increase in taxable income mainly generated by Smiles. In addition, we also incurred in an increase in deferred taxes primarily due to the realization of miles issued prior to the segregation of Smiles.

Loss For The Period

As a result of the foregoing, we had net losses of R$724.6 million in 2013 as compared to net losses of R$1,512.9 million in 2012.

Year 2012 Compared to Year 2011

In 2012, our total revenue passenger kilometers (RPK) increased by 5.6% as compared to 2011, mainly due to the consolidation of Webjet’s fleet and route network since the last quarter of 2011. On the other hand, Gol’s total RPK (including Webjet figures) decreased by 3.8% as compared to 2011, mainly due to the slowing of Brazil’s economy as measured by year-over-year GDP growth.

Demand in Brazil, as measured in revenue passenger kilometers (RPK), increased by 2.7% in 2012 when compared to 2011. International demand in revenue passenger kilometers was stable in the same period and capacity in Brazil, as measured by available seat kilometers (ASK), increased by 2.7%. These modest growth figures reflect a reduction of flights in our route network, an industry-wide response to new cost levels, sluggish Brazilian GDP growth and a changing focus towards route profitability. In the fourth quarter of 2012, domestic supply fell by 5.1% as compared to the same period in 2011. The fourth quarter, traditionally a period of increased travel, experienced its first decrease in supply since 2003.

During the course of 2012, we concentrated on adapting our operations to the current macroeconomic scenario, becoming a more efficient airline by adjusting domestic capacity and focusing on established, profitable routes. In the second half of 2012, this strategy began to yield results, such as a 4.0 percentage points increase in load factor and a 6.0% increase in passenger revenue per available seat kilometer (PRASK) over second half of 2011 figures. Also in the second half of 2012, our pro-forma domestic supply fell by 6.5% as compared to the same period in 2011 (including Webjet’s 2011 figures), contributing to a 4.0 percentage points increase in the domestic load factor.

In 2012, our domestic supply decreased by 5.4% as compared to 2011 (including Webjet’s 2011 pro-forma figures). Domestic demand (considering Webjet’s figures for 2011) decreased by 3.8%, due to our strategy of increased route efficiency implemented during 2012. In the international market, our demand and capacity decreased by 2.6% and 5.0%, respectively, primarily due to the discontinuation of flights to Bogotá, Colombia, and the winding down of international charter flights using Boeing 767 aircraft, partially offset by new international routes to Santo Domingo (Dominican Republic), Miami and Orlando.

In the same period, our total demand and capacity (considering Webjet’s figures for 2011) experienced decreases of 3.7% and 5.4%, respectively, primarily in response to new industry cost levels and sluggish Brazilian GDP growth.

The table below presents certain data from our results of operations for the periods indicated:

	Year Ended December 31,	
	2011	**2012**
Income Statement Data	**(in millions of *reais*)**	
Operating revenues		
Passenger	6,713.0	7,160.0
Cargo and other	826.3	943.6
Total operating revenues	**7,539.3**	**8,103.6**
Operating expenses		
Salaries, wages and benefits	(1,560.4)	(1,569.7)
Aircraft fuel	(3,060.7)	(3,742.2)
Aircraft rent	(505.1)	(644.0)
Sales and marketing	(402.6)	(426.6)
Landing fees	(395.2)	(559.4)
Aircraft and traffic servicing	(484.6)	(528.7)
Maintenance, materials and repairs	(434.2)	(418.0)
Depreciation and amortization	(395.8)	(519.6)
Other operating expenses	(633.6)	(600.9)
Gain on bargain purchase	88.4	-
Total operating expenses	**(7,783.8)**	**(9,009.2)**
Loss from operations before financial income (expense)	**(244.5)**	**(905.6)**
Interest expense	(414.4)	(453.7)
Financial income (expense), net	(341.5)	(225.5)
Loss before income taxes and social contribution	**(1,000.4)**	**(1,584.8)**
Income taxes	248.9	71.9
Net loss	**(751.5)**	**(1,512.9)**

Operating Revenue

Operating revenue increased by 7.5%, from R$7,539.3 million in 2011 to R$8,103.6 million in 2012:

	Year Ended December 31,		
Operating Revenue	**2011**	**2012**	**Chg.%**
	(in millions of *reais*, except percentages)		
Operating revenue	7,539.3	8,103.6	7.5%
Passenger	6,713.0	7,160.0	6.7%
Cargo and other	826.3	943.6	14.2%

Passenger operating revenues increased by 6.7% from R$6,713.0 million in 2011 to R$7,160.0 million in 2012. This variation was primarily due to the consolidation of Webjet's net revenue in 2012, 1.8 percentage points increase in load factor and 1.0% increase in yields between the periods. Consolidated passenger revenue per ASK increased by 3.6% year-over-year.

Ancillary revenue increased by 14.2% from R$826.3 million in 2011 to R$943.6 million in 2012, accounting for 11.6% of net revenue in 2012, primarily due to: (i) the consolidation of Webjet's ancillary revenue; (ii) the 17.5%

increase in revenue from fees for flight rebooking, no-show, passenger services and ticket cancellations; (iii) the 27% increase in excess baggage revenue; and (iv) an increase of approximately 2% in cargo revenue, which accounted for approximately 4% of our total gross revenue. Consolidated ancillary revenue per ASK increased by 11.0% year-over-year.

On a unit basis, revenue per available seat kilometer (RASK) increased by 4.5% from R$15.0 cents in 2011 to R$15.6 cents in 2012.

Operating Expenses

Operating expenses increased 15.7% from R$7,783.8 million in 2011 to R$9,009.2 million in 2012, primarily due to: (i) the consolidation of Webjet's operating expenses; (ii) additional expenses of R$140 million related to the winding up of Webjet's activities recorded in the fourth quarter of 2012; (iii) impairment of R$56.8 million on *Varig* tradename; (iv) consistently high jet fuel prices during the course of 2012 (in *reais* approximately 18% greater than 2011); (v) a 17% average depreciation of the *real* against the U.S. dollar; and (iv) increased landing and navigation assistance fees resulting from new fee calculation methodologies introduced by Infraero.

The following table sets forth our total operating expenses for the periods indicated:

	Year Ended December 31,		
Operating Expenses	**2011**	**2012**	**Chg.%**
	(in millions of *reais*, except percentages)		
Salaries	(1,560.4)	(1,569.7)	0.6%
Aircraft fuel	(3,060.7)	(3,742.2)	22.3%
Aircraft rent	(505.1)	(644.0)	27.5%
Sales and marketing	(402.6)	(426.6)	(5.9)%
Landing fees	(395.3)	(559.4)	41.5%
Aircraft and traffic servicing	(484.6)	(528.7)	9.1%
Maintenance, materials and repairs	(434.2)	(418.0)	(3.7)%
Depreciation and amortization	(395.8)	(519.6)	31.3%
Other operating expenses	(633.6)	(600.9)	(5.1)%
Gain on bargain purchase	88.4	-	(100.0)%
Total operating expenses	**(7,783.8)**	**(9,009.2)**	**15.7%**

On a per unit basis, our operating expense per available seat kilometer (CASK) increased by 12.5% from R$15.45 cents in 2011 to R$17.38 cents in 2012, mainly due to R$124 million of additional provisions (see note 11 to our consolidated financial statements included elsewhere herein) and other additional expenses related to logistics and passenger re-accommodation due to the end of Webjet's Operations (for a total of R$140 million), impairment of R$56.8 million on *Varig* tradename, higher CASK from fuel, aircraft rent, landing fees, and depreciation and amortization. The increase in CASK was partially offset by the 2.9% growth in supply (ASK). Operating expenses per available seat kilometer excluding fuel (CASK Ex-fuel) increased 8.4% from R$9.38 cents in 2011 to R$10.16 cents in 2012, mainly due to the extra costs related to the winding up of Webjet's activities, impairment on *Varig* tradename, higher expenses with aircraft rent, landing fees, and depreciation and amortization.

The following table sets forth certain of our operating expenses per available seat kilometer as a percentage of total operating expenses, for the periods indicated.

	Year Ended December 31,		
Operating Expenses per Available Seat Kilometer Breakdown	**2011**	**2012**	**Chg %**
Fuel	39.3%	41.5%	2.2%
Personnel	20.0%	17.4%	(2.6)%
Rent	6.5%	7.1%	0.6%
Maintenance	5.6%	4.6%	(1.0)%
Other	28.6%	29.3%	(0.7)%

The following table sets forth certain of our operating expenses per available seat kilometer for the periods indicated:

Operating Expenses per Available Seat Kilometer	**Year Ended December 31, 2011**	**2012**	**Chg %**
	(in cents of *reais*, except percentages)		
Salaries	(3.10)	(3.03)	(2.2)%
Aircraft fuel	(6.08)	(7.22)	18.8%
Aircraft rent	(1.00)	(1.24)	23.9%
Sales and marketing	(0.84)	(0.82)	(1.9)%
Landing fees	(0.78)	(1.08)	37.5%
Aircraft and traffic servicing	(0.96)	(1.02)	6.0%
Maintenance, materials and repairs	(0.86)	(0.81)	(6.4)%
Depreciation and amortization	(0.79)	(1.00)	27.6%
Other operating expenses	(1.04)	(1.16)	11.2%
Operating expenses per available seat kilometer (CASK)	**(15.45)**	**(17.38)**	**12.5%**
CASK excluding fuel expenses	**(9.38)**	**(10.16)**	**8.4%**

Aircraft fuel expenses increased by 22.3% from R$3,060.7 million in 2011 to R$3,742.2 million in 2012, largely due to the 18% increase in the price of jet fuel in *reais*, as well as the 3.6% consolidated increase in fuel consumption due to the consolidation of Webjet's fleet and the 17% average period depreciation of the *real* against the U.S. dollar. In per available seat kilometer terms, aircraft fuel costs increased by 18.8%, due to the same reasons, although diluted by the increase in available seat kilometers in the year-over-year comparison.

Salaries remained almost stable, increasing 0.6%, from R$1,560.4 million in 2011 to R$1,569.7 million in 2012, due to the addition of a full year of Webjet employees on our payroll, largely offset by a 13.6% year-over-year decrease in our workforce, in line with our strategy of reducing capacity in Brazil's domestic market, partially compensated with the impact of a 6.0% salary increase for 2013 on payroll expenses. In per available seat kilometer terms, salaries, wages and benefits decreased by 2.2%, due to these same reasons mentioned above in addition to the increase in available seat kilometers in the year-over-year comparison.

Aircraft rent increased by 27.5%, from R$505.1 million in 2011 to R$644.0 million in 2012, due to the greater average number of aircraft under operational leasing contracts (86 in 2011 as compared to 99 in 2012), combined with the 17% average period depreciation of the *real* against the U.S. dollar, given that most aircraft leasing costs are denominated in U.S. dollars. In per available seat kilometer terms, aircraft rent increased by 24.3%, due to the same reasons, although diluted by the increase in available seat kilometers in the year-over-year comparison.

Sales and marketing expenses remained almost stable, decreasing 5.9%, from R$402.6 million in 2011 to R$426.6 million in 2012, due to the decrease in sales between the periods. The expense was partially offset by the increase by approximately 35% year-over-year in purchase of mileage points of international partners, mainly due to the establishment of more complex relationships with mileage partners and the implementation of an online platform to redeem partners' air tickets through the *Smiles* website. In per available seat kilometer terms, sales and marketing expenses decrease 1.9%, due to the same reasons, although diluted by the increase in available seat kilometers in the year-over-year comparison.

Landing fees increased by 41.5% from R$395.2 million in 2011 to R$559.4 million in 2012, due to: (i) the negative impact of the new landing and navigation fee calculation methodology introduced by INFRAERO during the course of 2011; (ii) the 6.9% increase in the number of departures as a result of the consolidation of Webjet's operations; and

(iii) the 17% average period depreciation of the *real* against the U.S. dollar, which had an adverse impact on international landing fees. In per available seat kilometer terms, these fees increased by 37.5%, due to the same reasons, although diluted by the increase in available seat kilometers in 2012.

Aircraft and traffic servicing expenses increased by 9.1% from R$484.6 million in 2011 to R$528.7 million in 2012, mainly due to: (i) the 6.9% increase in the number of arrivals and departures, mainly as a result of the consolidation of Webjet's operations, as operational volume affects expenses from handling, collection and forwarding, among others; and (ii) the 17.0% average period depreciation of the *real* against the U.S. dollar, which had an adverse impact on our international operations. In per available seat kilometer terms, these costs increased by 6.0% in the same period, due to the same reasons, although diluted by the increase in available seat kilometers in the year-over-year comparison.

Maintenance, materials and repairs decreased by 3.7% from R$434.2 million in 2011 to R$418.0 million in 2012, due to: (i) a reduced number of engine removals; (ii) a decline in average unit engine maintenance cost as a result of the benefits from a complete year of the maintenance agreement entered into with Delta Tech Ops in 2011; and (iii) the effects of expenses related to the return of three Boeing 767s in the second quarter of 2011 that did not occur in 2012. The decrease was partially offset by the consolidation of Webjet's maintenance expenses and the 17% average period depreciation of the *real* against the U.S. dollar, given that most maintenance expenses are U.S. dollar-denominated. In per available seat kilometer terms, maintenance, materials and repairs decreased by 6.4%, due to the same reasons, although emphasized by the increase in available seat kilometers in the year-over-year comparison.

Depreciation and amortization expenses increased by 31.3% from R$395.8 million in 2011 to R$519.6 million in 2012, mainly due to the: (i) higher average number of aircraft under finance leases (45 in 2012 versus 42 in 2011); (ii) addition of six Boeing 737-300 aircraft owned by Webjet; (iii) increase in the depreciation of estimated aircraft reconfiguration costs which will be incurred when the aircraft are returned; and (iv) costs from improvements related to major engine maintenance established in the contracts. In per available seat kilometer terms, depreciation and amortization increased by 27.6%, due to the same reasons, although diluted by the increase in available seat kilometers in 2012.

Other operating expenses (mainly crew travel and accommodation, direct passenger expenses, equipment leasing and general and administrative expenses) increased 10.2% from R$545.2 million in 2011 (including gain on bargain purchase of R$88.4 million in 2011) to R$600.9 million in 2012 due to: (i) additional expenses related to the winding up of Webjet's activities recorded in the fourth quarter of 2012; (ii) impairment of R$56.8 million on *Varig* tradename; (iii) the 6.9% increase in take-offs; and (iv) the 17% average period depreciation of the *real* against the U.S. dollar. This was partially offset by: (i) R$90 million in additional expenses recorded in 2011 (contractual penalty of approximately R$25 million from the early return of three Boeing 767s, expense of R$10.0 million from the termination of an agreement with a baggage-handling provider, expenses of R$5.0 million due to flight cancellations and delays due to volcanic ash from an eruption in Chile and additional expenses of R$50.0 million associated with system improvements and developments, the optimization of the route network and a provision for an insurance reimbursement); (ii) impairment losses of R$51 million related to VRG and Webjet's fixed assets; (iii) an expense of R$21.7 million related to the revision of the criteria used to calculate contributions for PIS and COFINS recorded in 2011; and (iv) the gain on bargain purchase of R$88.4 million recorded in 2011. In per available seat kilometer terms, other operating expenses decreased by 25.2%, due to the same reasons, although emphasized by the increase in available seat kilometers in the year-over-year comparison.

Net Financial Result

Our net financial expense decreased by 11.6% from R$755.9 million in 2011 to R$679.2 million in 2012 primarily as a result of the gain on derivative instruments and lower expenses related to exchange variation, partially offset by an increase in other financial expenses and interest on loans due to the average period depreciation of the *real* against the U.S. dollar, given that most of our debt is denominated in foreign currency.

	Year Ended December 31,		
Financial Result	**2011**	**2012**	**Chg. %**
	(in millions of *reais*)		
Interest on short and long-term debt	(414.4)	(453.7)	9.5%
Exchange rate changes, net	(398.9)	(284.6)	(28.7)%
Derivative net results	(52.4)	50.3	(196.0)%
Investment funds	147.5	99.3	(32.7)%
Other financial expenses	(37.7)	(90.5)	140.3%

Net financial results	**(755.9)**	**(679.2)**	**(10.1)%**

Interest on loans increased by 9.5% in 2012 as compared to the 2011, due to: (i) interest on approximately R$230 million in additional net funding; (ii) an 8.9% year-over-year increase in the period-end *real* to U.S. dollar exchange rate (which adversely affected our dollar-denominated debt (equivalent to 70% of our total debt as of December 31, 2012); and (iv) the greater average number of aircraft under finance leases (45 in 2012 as compared to 42 in 2011);

Exchange variation decreased by 28.7% in 2012 as compared to 2011, mainly due to lower exchange volatility in 2012 than in 2011, when the *real* depreciated from R$1.56/US$ at the end of the second quarter to R$1.85/US$ at the end of the third quarter, adversely affecting our financial liabilities in the period. The exchange rate volatility has a direct impact on foreign-currency-denominated financial assets and liabilities.

Investment funds decreased by 32.7% in 2012 as compared to 2011, mainly due to a lower volume of cash invested between the periods and a reduction in the SELIC rate, given that most of our cash investments are pegged to the CDI interbank rate (directly correlated with the SELIC rate).

In 2012, we recognized derivative financial instruments net gain of R$50.3 million. As of December 31, 2012, we had derivative positions in place to hedge approximately 21%, 9%, 7%, 7% and 6% of our estimated jet fuel consumption for the first, second, third, and fourth quarters of 2013 and after that until the first quarter of 2015, respectively.

Other financial expenses increased by 140.3%, from R$37.7 million in 2011 to R$90.5 million in 2012, mainly due to: (i) the consolidation of Webjet's other financial expenses; (ii) expense of R$8.1 million in connection with waiver fees paid to holders of our Debentures IV and V recorded in the first quarter of 2012; (iii) a loss of R$11.1 million in escrow deposits related to the acquisition of Webjet; and (iv) other financial expenses totaling approximately R$6.0 million related to adjustments to the present value of Webjet's liabilities.

Income Tax

Income tax expenses decreased by 71.1%, from a credit of R$248.9 million in 2011 to a credit of R$71.9 million in 2012, mainly due to the recognition of a valuation allowance on carryforward tax losses.

Income (Loss) For The Period

As a result of the foregoing, we had net losses of R$751.5 million in 2011, versus net losses of R$1,512.9 million in 2012.

B. Liquidity and Capital Resources

Cash Flow Analysis

Operating Activities. Our strategy is to rely primarily on cash flows from operations to provide working capital for current and future operations. In 2013, we generated R$403.9 million in cash from our operating activities reflecting the increase in our operating profitability. In 2012, net cash generated by operating activities was R$133.3 million while, in 2011, net cash used was R$602.5 million.

Operating activities refer to the main revenue-producing activities of the Company and other activities that are not investing or financing activities. In 2013, cash generated by operating activities was positively impacted by (i) R$396.6 million in advance ticket sales, which can be explained by an increase in our average yields and (ii) R$163.0 million related to our mileage program. These were partially offset by (i) the R$116.3 million decrease in cash deposits and (ii) the R$570.6 million decrease in financial applications. In order to reconcile our net loss, the following effects should not be considered: (i) exchange variation in the amount of R$598.6 million, (ii) depreciation and amortization in the amount of R$561.0 million and (iii) interest on loans in the amount of R$248.8 million.

Cash flows associated with derivative financial instruments, which are also classified as operating cash flows, generated net inflows of R$49.4 million in 2013 and net outflows of R$37.8 million and R$42.3 million in 2012 and 2011, respectively.

As of December 31, 2013, we had R$412.5 million of maintenance reserve deposits under our aircraft operating leases. Funds will be drawn from the maintenance reserve accounts to reimburse for certain structural maintenance expenditures incurred. We believe the amounts deposited (and to be deposited) plus our own cash resources will be sufficient to service our future aircraft maintenance and other costs for the duration of the applicable operating leases.

Investing Activities. In 2013, net cash used in investing activities was R$318.9 million. In 2013, we invested R$51.0 million in intangibles, while acquisition of fixed assets were R$238.0 million, R$454.2 million and R$279.8 million in 2013, 2012 and 20111, respectively, primarily due to pre-delivery deposits for the acquisition of Boeing 737 aircraft. In 2013 and 2012, acquisition of fixed assets was also impacted by improvements related to major engine maintenance performed in accordance to our lease agreements.

Financing Activities. Net cash generated by financing activities totaled R$807.2 million in 2013 and consisted primarily of: (i) a R$1,096.0 million capital increase related to Smiles' IPO; and (ii) R$404.0 million in funding operations closed during the year. These proceeds were partially offset by the R$676.6 million in aircraft lease and debt payments.

In 2012, net cash used in financing activities totaled R$4.4 million and consisted primarily of: (i) R$312.4 million in funding operations during the year; and (ii) R$17.3 million of sale of stocks held in treasury. These proceeds were offset by (iii) R$334.7 million outflow for the repayment of debt and aircraft lease payments.

In 2011, net cash generated from financing activities totaled R$354.5 million and consisted primarily of capital raised from: (i) the issuance of our fifth series of debentures in the amount of R$500 million; and (ii) the equity investment in the amount of R$182 million made by Delta Airlines. These proceeds were offset by (iii) the prepayment of working capital credit lines and other debt which would have matured in the medium term, therefore reducing the risk of us having to refinance debt and aircraft finance lease payments in the short term.

Liquidity

In managing our liquidity, we take into account our cash and cash equivalents, short-term investments and short and long-term restricted cash, as well as, our accounts receivable balances. Our accounts receivable balance is affected by the payment terms of our credit card receivables. Our customers can purchase seats on our flights using a credit card and pay in installments, typically creating a one, or two, month lag between the time that we pay our suppliers and expenses and the time that we receive payment for our services. When necessary, we obtain working capital loans, which can be secured by our receivables, to finance the sale-to-cash collection cycle.

Our cash position as of December 31, 2013 was equivalent to 34.0% of our trailing twelve months' operating revenues (reaching our initial target of at least 25.0% of the trailing twelve months' operating revenues). This position also covers seven times our short-term debt, which we believe currently is an appropriate level of liquidity. We are also committed to having no significant financial debt maturities (excluding finance leases) coming due within any two-year horizon.

As of December 31, 2013, we had R$251.2 million in cash held in our subsidiaries outside Brazil, of which R$195.1 million were held in Venezuela. For more information on risks associated with the repatriation of funds held outside Brazil, see "Risk Factors—New and existing regulations and government actions regarding the repatriation of funds as well as the devaluation of currencies in foreign countries where we have operations could adversely affect us."

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The following table sets forth certain key liquidity data at the dates indicated:

	At December 31,		
	2012	**2013**	***% Change***
	(in millions of *reais*)		
Real Denominated	**1,521.3**	2,268.5	49.1%
Cash and Cash Equivalents	450.3	995.9	121.2%
Short-Term Investments and Short and long-Term Restricted Cash	763.5	988.1	29.4%
Short-term Receivables	307.5	284.5	-7.5%
Foreign Exchange Denominated	**864.9**	**1,569.9**	**81.5%**
Cash and Cash Equivalents	325.3	639.7	96.7%
Short-Term Investments	46.1	422.0	815.4%
Short-term Receivables	18.2	40.4	121.7%
Advances for acquisition of aircraft	475.3	467.8	-1.6%
Total	**2,386.2**	**3,838.4**	**60.9%**

As of December 31, 2013, cash and cash equivalents, short-term investments and short and long-term restricted cash were R$3,045.7 million, comprised by R$1,635.6 million in cash and cash equivalents, R$1.155.6 million in short-term investments representing immediate liquid financial assets and R$254.5 million in restricted cash. The increase in total cash deposits, as compared to 2012, is primarily due to cash resources deriving from Smiles' IPO, which were used for the purchase of advanced flight tickets by Smiles as well as the increase in our operating profitability.

Short-term receivables include mainly credit card sales and accounts receivables from travel agencies and cargo transportation. At the end of 2013, our volume of short-term receivables was stable as compared to 2012.

As of December 31, 2013, we had R$467.8 million deposited with Boeing as advances for aircraft acquisitions, a decrease of 1.6% as compared to December 31, 2012, mainly due to aircraft deliveries made in 2013 and the lower number of new aircraft deliveries scheduled under our fleet plan for the next 12 months. As a result, our total cash deposits were R$3,838.4 million as of December 31, 2013 as compared to R$2,386.2 million at December 31, 2012.

Indebtedness

The following table sets forth our loans and financings at December 31, 2013 and 2012:

	At December 31,		
	2012	**2013**	**% Change**
	(in millions of *reais*)		
Loans and Financing	2,718.6	2,891.7	