

Q2 2011 Earnings Call

Company Participants

- Frederico Curado, Empresa Brasileira de Aeronautica S.A.
- Paulo Penido, Empresa Brasileira de Aeronautica S.A.

Other Participants

- Joe Nadol, Analyst
- Nicolai Sebrell, Analyst
- Noah Poponak, Analyst
- Pete Skibitski, Analyst
- Ron Epstein, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. and welcome to the audio conference call that will review Embraer's Second Quarter 2011 results. Thank you for standing by. (Operator Instructions) As a reminder, this conference is being recorded and Webcasted at www.Embraer.com.

This conference call includes forward-looking statements or statements about events or circumstances which have not occurred. Embraer has based these forward-looking statements largely on its current expectations and projections about future events and financial trends affecting the business and its future financial performance. These forward-looking statements are subject to risks, uncertainties, and assumptions, including, among other things, general economic, political, and business conditions in Brazil and in other markets where the Company is present. The words believes, may, will, estimates, continues, anticipates, intends, expects, and similar words are intended to identify forward-looking statements.

Embraer undertakes no obligations to update publicly or revise any forward-looking statements because of new information, future events, or other factors. In light of these risks and uncertainties, the forward-looking events and circumstances discussed on this conference call might not occur. The Company's actual results could differ substantially from those anticipated in the forward-looking statements.

Participants on today's conference call are Mr. Frederico Curado, President and CEO; Mr. Paulo Penido, Chief Financial Officer; Mr. Andre Gaia, Head of IR; and Mr. (Rodrigo Rosa), Controller.

I would now like to turn the conference over to Mr. Curado. Please, sir, go ahead.

Frederico Curado {BIO 2004589 <GO>}

Good morning, everyone. I will take this opportunity to introduce Paulo Penido to most of you who have not had a chance to meet him personally. He will be going to the United States soon to visit with you. And I'll ask Paulo just to go through our highlights. And as soon as we finish that, of course, we're going to open the Q&A and answer session, and we'll be here together to answer your questions. Thank you.

Paulo Penido {BIO 4384213 <GO>}

Thank you. Good morning, everybody. It's a pleasure to be with you for the first time. I'm quite excited with my new challenge and position here in Embraer.

I would like to go through this 18-page introduction, starting on page 3, please, where we show the commercial jets, let's say, recent highlights. First, market demand is happening, is there. At the Paris Air Show, we did four new deals. One was a company from Indonesia. Another one was a company from Kenya and two others was companies from the US.

In the first half of 2011, we delivered 45 jets, and we sold 62 E-jets. And we have reached 1,003 firm orders, which is a remarkable level. In (additional), there were 42 additional aircraft pending final documentation, totaling 104 in the first half of 2011.

We continued to expand our client base. We have three new airlines added -- one from Austria, one from Kazakhstan, and one from Bulgaria.

On page 4, please, talking about executive jets, we signed a strategic operation agreement with Minsheng in China, and it may turn into 20 executive -- the sale of 20 executive jets. We expect it.

In EBACE, we were able to see the first signs of recovery in this part of the industry, and we got some few orders -- some new, few orders.

And just to (inaudible), we have delivered our Phenom number 200 to Swift Aviation Group.

On page 5, talking now about Defense and Security, we have sold eight Super Tucanos to the Indonesian Air Force, and we continue to develop our KC-390. And currently, we have just defined most of the strategic partnership suppliers, and we are now entering in the joint definition phase of the product.

On page 6, we are showing the revenue by segment. We had, let's say, meaningful growth in revenues when comparing the First Quarter of 2011 to the Second Quarter of 2011 and, I would say, a somewhat stable breakdown of revenues by segment.

Now on page 7. In the Second Quarter of 2011, we have sold -- we have delivered 25 commercial jets, 3 executive, large jets, and 20 executive, light jets, quite in line with our, I would say, budget and our expected levels.

Page eight is the firm order backlog; again, stable -- a small reduction, but it's normal there is some fluctuation on it.

Now on page 9, talking about revenues and gross margin, I would like to highlight the better margins that we are presenting in 2011 and the gross revenues that I already mentioned. So we are now facing 23% average margin in our business according to the IFRS, I would say, way to account it.

In terms of SG&A, it's somewhat stable when comparing in local currency in Brazil with some growth in US dollars. It's a result of the challenge of the appreciation of the local currency. The Company is working hard to control its costs and to face this challenge with some, I would say, meaningful success.

On page 11, income from operations, as you can see, growing income, reaching \$106 million in the Second Quarter of 2011.

Now EBITDA -- I would say quite stable in the first two quarters of the year. That's the message quite visual in the graphs on page 12 showing the EBITDA.

Now moving, just to continue to provide a view of the performance of the Company, net income, a little bit smaller due to some, I would say, tax payments, which is normal, again. So I would say stable. It was in the expected range for the Company.

In terms of inventories, a little bit higher than expected. The situation is normalizing. And the free cash flow that was negative in the first two quarters of the year tends to become positive already in the Third Quarter and finish the year at the positive level.

On page 15, the indebtedness. I would say no (new) news on it. The Company still has a sound position, a net cash position of over \$400 million, which is a quite strong situation. The total cash at the end of the Second Quarter amounted to \$2.1 billion.

Now some good news in terms of guidance. The Company is revising its outlook. So net revenues we are now increasing from \$5.6 billion to \$5.8 billion. It's a 4% increase. In terms of EBIT, from \$420 million to \$465 million, an 11% increase. And in terms of EBITDA, from \$610 million to \$700 million, a 15% increase. Meaningful, I would say, new change on these figures.

Again, just finishing the outlook revision, our research and CapEx, I would say, expected expenditures are preserved or maintained, and we are reducing the development expense from \$210 million to \$160 million due to some agreements that we made with some partners where we were able to reduce it and preserve the development, I would say, work that we do all the time here.

That is the introduction that we were planning to do. We are now ready for the Q&A section. Thank you.

Questions And Answers

Operator

(Operator Instructions) Noah Poponak, Goldman Sachs.

Q - Noah Poponak {BIO 16071528 <GO>}

As we look into the second half, can you speak to the degree to which you think your regional jet order activity can keep up with the pace that you had in the first half? Do you think you can match what you did in the first half?

A - Frederico Curado {BIO 2004589 <GO>}

As you know, it's always tough to talk about ongoing sales. What I think I can say is that we have in the pipeline the volume of deals that we are engaged and in discussions -- of course, that will depend on how successful we are -- but, at least, the volume of airplanes involved in what we are discussing at this stage, yes, would more or less keep up the pace of the first semester. This thing is kind of zero to one -- kind of a digital. Either we win, or we do not win. But we have not seen a reduction of the traction of this market recovery that we have seen in the first half.

Q - Noah Poponak {BIO 16071528 <GO>}

Okay. That's very good. Any much-larger-than-average, single campaigns you're working, or is it more just a lot of small to medium-sized?

A - Frederico Curado {BIO 2004589 <GO>}

Well there is at least one I think we can comment about because it's public, which is Delta Airlines. That may become a large order. But again, it's a -- the winner-takes-all sort of campaign. But we also have options being discussed to be converted into firm. But at least this one large campaign is out there.

Q - Noah Poponak {BIO 16071528 <GO>}

Okay. As we look out beyond 2011 into the next year or two, it would seem clear that RJ Production has to increase. Can you help give us a sense of the boundaries that you're looking at in terms of how much higher RJ Production needs to go next year?

A - Frederico Curado {BIO 2004589 <GO>}

We do not have a clear vision yet. I just am afraid to give any guidance at this stage because, if I give you some boundaries of -- fundamentally, I'd be giving you guidance as far as revenues in that segment for the next year. But let me say this. The likelihood that we're going to have some increase -- I do not expect any huge increase. It would be

something more like just an organic increase of our production rates. But the likelihood that that happens is very high at this stage.

So maybe in the next earnings call, maybe we can be more assertive than we are now. It will depend. Some of the campaigns which are going on -- we do have some 2012 positions on top of what we already have, which may move this line a little bit north or south as far as the growth. But the chances that we're going to have more aircraft than this year is very high, as I've said.

Q - Noah Poponak {BIO 16071528 <GO>}

Okay. Then I'll ask one more. In the Defense segment, the press release talks about some opportunities that are hitting now that are helping you there. Can you just elaborate on what those are?

Then, can you also remind us about the opportunity set you have around the country's Homeland Security efforts ahead of the World Cup and the Olympics and specify how big those can be and the timing in which they can become real?

A - Frederico Curado {BIO 2004589 <GO>}

Well there is -- at this stage, I think what we have done is really to think -- as we diversify our focus from, let's say, the Air Force and from flying systems and flying objects to something which is also applicable to Navy, Army, and security forces, Homeland Security, and stuff, the addition of the two new companies that we have taken a stake hold in, OrbiSat (inaudible) radars and Atech, they kind of complement our capability, and they broaden the scope of potential participation of Embraer in other programs.

The Brazilian government budget is somewhat under constraint since the early part of this year. So some large contracts which are expected to happen, there is some questions whether or not they're going to be launched this year or next year; just to mention one of them is the FX, of course the fighter program. But there are others. There are such as the monitoring of the frontiers of Brazil. There is also the monitoring of what we call the Blue Amazon, which is the offshore platform, where you have all the (inaudible) stuff.

So there are some major programs where, traditionally, we would not be, let's say, a natural player that I think we are now. We are players. So we are evaluating how we can put together an architecture that allows us to take a prime role in those new contracts. But again, they're all subject to the Brazilian budgetary system.

Having the two major events coming up in the next few years gives us some hope --let's say, hopefully, some certainty that there will be procurements out there beyond the scope of what we have traditional participated or beyond the Air Force, where we're certainly going to fight very hard to take a prime role or at least to take a major role in satisfying those requirements. So it's more kind of a potential, let's say, capture of new customers and new contracts than something that's very, very short term.

It will fundamentally depend on how the Brazilian budgetary provisions will develop in the next 16, 12, 18 months. So far in this year, there has been a constraint -- artificial constraint with the budget. Maybe with the extra tax revenues that the government has had in the first half -- maybe there will be a little bit of more easing of that in the second half. But that we do not know. That's a very sophisticated and complex political decision.

Q - Noah Poponak {BIO 16071528 <GO>}

Okay. Thanks for taking my questions. And it's really an excellent quarter, so congratulations on that.

Operator

Ron Epstein, Bank of America.

Q - Ron Epstein {BIO 1868102 <GO>}

Fred, just going to ask the question, I think, that's on everybody's mind. What's next in terms of the next commercial airplane? What options does Embraer have in front of it, given now that Boeing's made their move, Airbus has made their move, and Bombardier has made their move?

A - Frederico Curado {BIO 2004589 <GO>}

We are focusing beyond what we -- first, obviously, is to keep the leadership in where we are. This is obvious. But we are narrowing our analysis to the next, adjacent segment, which -- the segment you can characterize today as where the 319, the 737-700, and the Bombardier CSeries are today. So that is what we are analyzing. We're not analyzing a head-to-head 320 or 737-800 airplane.

But in between the E-Jets and those two, let's say, center-line airplanes, we are evaluating what is the size of the market and what are our chances with a new aircraft or with a revamped aircraft based on the 195 to capture some market share that could justify investments in there, taking into account that the 319 will be re-engined. And we do not have clarity right at this stage whether or not the 700 will be re-engined or not, but we are assuming it will. And fundamentally, I don't think there will be much of a difference in our decision at this stage. So either we are able to bring something which has compelling (advantages) over the current offers there, or, of course, it would not make any sense for us to try to invest and get it there.

As I said, I think the two ways to get there -- one is to develop a new family -- probably a two-member family of airplanes. The other is not to do that and to try to stretch and re-wing and re-engine the 195 with a single offer -- and, obviously, with pros and cons. We're going to weigh the two options. I sincerely do not have any weighting on whether one or the other is more likely to happen.

But fundamentally, the lower investment, lower potential capture of market share, versus a higher investment and a clean sheet of paper and fully optimized and potentially larger

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aircraft if we opt for a new one, but with a higher investment. So that's the tradeoff that we have to get to put into paper and make a decision.

And having said all that, I do anticipate that before yearend, we will make a decision on how -- if and how we're going to address that next segment to the E-Jets.

Just one final comment, just to complete my answer, is that if we decide to go with new airplanes, they will have commonality with the existing E-Jets. So preserving our customer base -- not only preserving, but giving our customer base a potential upgrade, a natural flow into the future, is absolutely the number-one priority for us. We have 60 customers, and the E-Jets will be around for a long time. The E-Jets ten years from now will not be the same as they are today, but there will be an E-Jet there. And I'll tell you whatever we do is going to be to the benefit of our existing customer base.

Q - Ron Epstein {BIO 1868102 <GO>}

Great. Thank you for that answer.

Then maybe just a smaller detail. With production rates going up kind of across the industry now, we've heard from a lot of the commercial aerospace suppliers that their original equipment businesses are up 20%, 30%. How is your supply chain doing? Are there any areas of the supply chain that you're worried about or not? Does it seem to be okay? If you can discuss that.

A - Frederico Curado {BIO 2004589 <GO>}

Ron, our raises -- our potential increase in our production rate, I would say, is relatively thin as compared to what we have seen in the narrow-body -- in the larger, narrow-body programs. So no bottlenecks in sight. Very clear communication, as always.

There is a concern, obviously, with the suppliers in Brazil, not because of bottlenecks or anything like that but because of cost. So as we have -- we're fully hedged as far as having contracts in US dollars. But the pressure that we are feeling on our costs, this is also valid for our suppliers in Brazil. So just to mention -- just to give you 100%, complete answer.

Other than that -- and, again, that, we do not foresee any negative consequences either. We would have relatively -- it would be relatively easy to absorb, as we have done already a few times -- absorb current outsourced work back into the factory. As everybody knows, we do have some available capacity. And so the answer is we are pretty okay. We're pretty comfortable about what we need to do and having our supply chain on board with us with no foreseeable difficulty.

Q - Ron Epstein {BIO 1868102 <GO>}

Okay. Then maybe just one more. With the change in rules in terms of, I guess, FX hedging and derivatives -- right -- I guess was just announced about two days ago -- as an exporter, how does that impact you or not? I mean, will the tax on any FX hedges impact

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you guys or not, for clarity? I think a lot of folks don't understand the difference between -
- for an exporter or for a domestic producer.

A - Frederico Curado {BIO 2004589 <GO>}

Ron, the measures, they were pretty complex. And to date, nobody has come up with a clear diagnosis of what the implications are. So it's -- well, for us, if it does result into a valuation -- or devaluation of the real, that's great news. As we have no derivatives in our financial portfolio, there is no downside whatsoever for us in that aspect. But I think the real question is whether or not the measures will be effective to stop this continuous strengthening of the real vis-a-vis the US dollar.

I can give you my personal view on this thing as a Brazilian. I think, until the point that Brazil really addresses that issue with a combination of monetary policy and fiscal policy -- to date, we have basically been playing on the monetary policy -- I don't see a major change in the trends of the strengthening of the real. I think, without a meaningful -- without a real, let's say, diet on the Brazilian government's side, I mean, the Central Bank and the Minister of Economy, they'll keep trying to support the Brazilian exporters trying to act in the market, preserving some rational exchange rates.

But I think the fundamentals that are depressing the US dollar in Brazil or overvaluing the real in Brazil -- they are still there. The government has a large deficit. It has to refinance that deficit. And for that, has very high interest rates. There is a huge arbitration potential for investors. Money keeps flowing into the country. That is very, very strong -- that's a very strong, let's say, driver to be offset by prudential measures such as these ones. But again, this is a very generic view.

And how does that impact us? Again, if it's successful, great. If it is not, it's life as usual, and we are -- we're not counting on any major miracle reverse on this exchange rate. We are working very hard to offset that with all the classical tools -- productivity, quality, lead time reduction, reduction in inventories, et cetera, et cetera, et cetera. So any headwinds -- any tailwinds that we get, it's great news. Let's see. It's, as I said, complex. Maybe I'm just too conservative. Maybe it will bring the dollar up. If it does, great. If it does not, we are prepared for that already.

Q - Ron Epstein {BIO 1868102 <GO>}

Okay. Great. And again, nice quarter. Thanks.

Operator

Pete Skibitski, (Sunset).

Q - Pete Skibitski

It was SunTrust. Good morning. I might have missed this, but can you give us some more color on what drove the sales guidance increase?

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A - Frederico Curado {BIO 2004589 <GO>}

Actually, we did not give any color other than the number. But it's probably still going to be driven by commercial jets and a combination of defense and services. The one business that we do not see at this stage an upside as far as revenues is the business jets. We still believe that we'll be able to achieve our guidance, but we do have a few challenges there. So getting all together, we feel relatively comfortable -- well, we feel very comfortable about this \$200 million extra in our revenues.

Q - Pete Skibitski

Okay. So you're still at 100 Phenoms for the year?

A - Frederico Curado {BIO 2004589 <GO>}

Yes. And 18 Lineage and Legacys.

Q - Pete Skibitski

Okay. Then, you touched on this, but I just wonder if you could elaborate a little bit in terms of how much more productivity gains are left available to you to help offset the strength in the real. And sort of combined with that, your guidance -- it seemed to imply some gross margin pressure in the second half of the year. I'm just wondering what's driving that -- if it's the real or something else.

A - Frederico Curado {BIO 2004589 <GO>}

No. As a matter of fact, it's not a pressure. As you may or may not recall, we had in the First Quarter of this year an extraordinary high gross margin. We had some events, some specific, nonrecurring items, that pushed our gross margin in the First Quarter beyond, let's say, the normal average. So we project a relatively stable second half, which will translate into a slightly lower EBIT than the first half. That's why we have adopted this 8% or something, which we believe we will be able to achieve.

Q - Pete Skibitski

Okay. Thank you very much.

Operator

Nicolai Sebrell, Morgan Stanley.

Q - Nicolai Sebrell {BIO 7321622 <GO>}

I was wondering, first, if you could talk about whether the change in guidance results in any upward pressure to the delivery schedule. I apologize if you did mention that, but I missed it.

Then, second, a little bit more about the executive jet business. Of course, prices still appear to be very weak in the used jet market. What impact is that having on your backlog? How healthy, really, do you think your backlog is? Because what we've seen or

what we have heard is that maybe there are a lot of guys who, instead of canceling orders, they're just delaying. I would guess that's some of the reason that the production numbers are down this year from last.

Then, if I could ask a second question, which is the upward margin revision that you made to the guidance, does that also indicate maybe greater long-term margin potential? I know, in the past, you've discussed a goal -- correct me if I'm wrong -- but a goal of like 10% plus operating margin, over the long term. Is that still, do you think, a reasonable goal? What's the outlook there?

A - Frederico Curado {BIO 2004589 <GO>}

Okay, Nicolai. The business jets -- the upside on the revenues we expect to come from a blend of defense, airliners, and service, but not from business jets, which takes us to the question of where we are. We have seen for the first time in a long time there is a pickup in the activity -- in the commercial activity; so, the level of consultations, of proposals and discussions. And also, I would say orders are starting to pick up, not to a point yet to be meaningful as far as the Company backlog, but, definitely, the direction now is a positive direction. So there is some traction back into the market. And so I think we can, for the first time in a long period, be a little bit more optimistic about the potential of business jets going forward.

The Phenom 300 has attracted a lot of interest. The Legacy 650 is getting traction as well. And even the Lineage, which is more of a niche product, is also getting some importance, proposals or interest, which I think makes us feel a little bit more optimistic about that.

Q - Nicolai Sebrell {BIO 7321622 <GO>}

Then -- sorry to interrupt. But that does lead into the question of the 450 and 500. When those get released, do you think that changes your business meaningfully? Do you think you could grab -- acquire more market share than what we've seen in the recent past?

A - Frederico Curado {BIO 2004589 <GO>}

Oh, yes, definitely. Today, we play in the Legacy 650 segment, which is a super-midsized segment. We play with the Lineage in, as I said, kind of a niche segment. It's a high-end and high-value aircraft, but the quantities are really more like a (inaudible) business -- (inaudible) BBJ or (inaudible) -- that sort of market. In the entry levels, the Phenom 300 playing in the small-cabin side. So we have a huge gap between the Phenoms and the 650.

The 500 and 450, we are still on for flying the first prototype of the 500 before yearend. This is the target. As always, in any development program, there are challenges, there are difficulties, et cetera, et cetera. But our vision today is to fly this airplane before yearend.

When we have those programs in, let's say, full deployment, I mean, the potential of the business is -- it could be easily to double the size of what we have. We're going to come into a market where we are not today. So we're adding two new products to our portfolio

with the potential to capture a significant market share in that, let's say, midsized cabin or even, almost, like super-midsized, in the case of the 500, that, yes, can have a material, positive impact to our business.

To your second question about -- is that okay, Nicolai?

Q - Nicolai Sebrell {BIO 7321622 <GO>}

Yes. Perfect. Thank you.

A - Frederico Curado {BIO 2004589 <GO>}

Okay. On your second question about long-term margins, yes, I think we, except on the First Quarter, where we did have some nonrecurring and positive events that boosted the gross margin upwards, we're feeling more and more comfortable that we are -- I mean, definitely on the right track in terms of productivity and increasing our margins. Relentless work in terms of streamlining and improving quality, et cetera, et cetera. The (inaudible) is very alive inside the Company. With demanding markets, there are pricing pressures, of course, but we are trying to keep it under and, so far, we have been able to manage those pricing pressures quite well. So we're not getting headwinds on that direction.

And I think, as soon as we have some relief in the exchange rate -- and it's not only exchange rate, if I may add. We have actually a double-dip situation in Brazil, because we have the exchange rate going the wrong direction for exporters, but, also, we have increases in costs in Brazil in reais. So it's a double effect. If we can -- that affects not only the gross margin -- the operating margin, but also the gross margin, but that goes straight to labor.

I have to believe that Brazil one day has to come back to a more, let's say, rational level as far as its costs. Brazil has become a very expensive country and too rapidly -- too rapidly for the industry to respond. I think Embraer has been one of the few exceptions of, let's say, non-primary goods and non-commodities industry that has been resisting to this too-rapid growth in the costs in Brazil.

So assuming that this won't be forever -- it cannot be forever; then the country will start to have other sort of problems -- yes, I think it should be more -- on the long term, this should be better off as far as adding what we are doing to some relief in the variables which are outside our control.

Q - Nicolai Sebrell {BIO 7321622 <GO>}

All right. That's very helpful, and congratulations.

Operator

Joe Nadol, JPMorgan.

Q - Joe Nadol {BIO 3056499 <GO>}

Congratulations on a good quarter.

My first question is, just to be very specific, that 22%-plus gross margin in the quarter, Fred, you think that's sustainable. There's nothing in there in terms of any mix benefit or any items? You feel comfortable that that level going forward, putting aside potential changes in currency -- but, everything else aside, that's a good level to think about going forward?

A - Frederico Curado {BIO 2004589 <GO>}

I think so. I think so. I think, as far as costs, I'm very comfortable with that. As far as pricing, at least in the visible horizon, we should be okay. We cannot disregard the (decrease) in potential competition from new entrants, which, so far, has been just (a few), like a promise. But we never disregard that more mid, long term. But I think if we are able to hold on the pricing side, on the cost side, I feel very comfortable.

Q - Joe Nadol {BIO 3056499 <GO>}

Okay. Then, you're going to make a decision by the end of the year on your way forward on the commercial side. So when we look at the research line in your income statement, you're spending money right now that you're expensing because you haven't launched a program yet under IFRS. But when you launch something, which you will do before next year, it sounds like, does that mean that line item should improve next year -- that expense should be down?

A - Frederico Curado {BIO 2004589 <GO>}

I expect some increase, not something which will be -- well, let me qualify what I'm saying. The reduction of guidance that we gave as far as development this year is not due to any reduction in activities. It's basically an advancement of contribution from partners, which we did not expect this year and it's going to happen this year, which helps the whole cash flow, et cetera. The \$210 million a year level, it's there. It's there, and I think there's a trend to increase that a little bit. There's, of course, the cost side of it with the labor.

But as we engage in a new program, we are already getting to a mature phase in the Legacy 500. So we will start releasing engineering resources in a more meaningful way in 2012/2013-ish, which that's when the new program is going to pick up, whichever the program is. So there is a natural balance of our engineering resources. But given the size of what we are doing in the business jet; given, also, the KC-390 -- you cannot forget that, although it is not expensed here because it's fully paid by the contract.

The resources are people. They are from the same pool of resources. So I think it's fair to say that we should expect some increase in the development costs. Research? Maybe a little bit. This \$100 million a year, it seems to be a relatively nice -- a reasonable level of a pretty competitive design. I think this is about it.

CapEx? Probably -- I don't know. It will depend how much -- how we develop the new program. But we are -- this high capacity is a result of the postponements we did in the last two years. Melbourne will be up and running by the end of this year. Portugal, Evora,

will be up and running the first half of next year. So it will depend what will be the CapEx for the new program. That's probably -- I have a little bit less visibility at this stage. But research also relatively stable. Development probably going a little bit up.

Q - Joe Nadol {BIO 3056499 <GO>}

Okay. My thinking was actually that research might decline, because my understanding is, once you've launched a new program, that a lot of what you're expensing now, even though your overall cash expense goes up, that a lot of your income statement expense actually gets capitalized, and so that might actually improve. That's not right? You would redirect dollars elsewhere that would keep that line relatively stable?

A - Frederico Curado {BIO 2004589 <GO>}

I'm not sure I fully understand, Joe. Let's take two dimensions. Once that level of gross resources and gross investments -- it tends to go up. Everything I told you about (technical difficulties).

Operator

Noah Poponak, Goldman Sachs.

Q - Noah Poponak {BIO 16071528 <GO>}

Well on the one hand, your provider dropped the call, but, on the other hand, they have some pretty amazing hold music. So it's going to be a tough call going forward.

A - Frederico Curado {BIO 2004589 <GO>}

I think Joe's question was a heck of a question that shut down the whole system.

Q - Noah Poponak {BIO 16071528 <GO>}

I wanted to pick back up on the next-gen product strategy and just try to get a better sense for maybe sort of where you're leaning or where you're not leaning. On the re-engine issue, it kind of looks like the seating and range of a 195 isn't that much different than a CSeries, and it's substantially less expensive. And so it would seem like, if you were able to get close to matching the engine technology, you'd be pretty competitive there. Is that how you're thinking about that?

And what have you -- -- or what is your insight into the engine offerings being able to get smaller? Because I think you guys had the issue of wing-to-ground clearance. Does that help resolve that, or what do we know about that at this point?

A - Frederico Curado {BIO 2004589 <GO>}

Okay. Noah, if you'd just allow me, because we broke up after I spoke here for a few minutes, before realizing that I was speaking to no one. And I was in the middle of Joe's -- Joe posed a question about research. If I may, just to finalize the thought -- I don't even know if Joe is still on the line or not.

But the research -- the development-- what I said about development is that, with a new program, the gross resource in development, I see some potential increase, not in a large amount, but an increase.

As far as research -- and I think that was his question -- if I understood correctly, his question was -- with a new program being launched, will we reduce the level of research that we spend today. And my (question) is probably not. This pretty competitive research is \$90 million a year. I think this order of magnitude, plus or minus, but materially the same -- I think this is what we need, really, to keep Embraer in the leading edge of technology and to have a future. So it's not only meant to that program; it's meant to the capacitation of the Company in the long run.

Now, to your question about the 195 engines, et cetera. There is a couple of considerations. The 195 today is an airplane which size is close to the 190. Fundamentally, it's changed, trading a few more seats for some range, and that's what it is. We did some exercise in the past about stretching the 195 (FEs), and the result was not very compelling because the engine -- you know, the engine is underpowered, the wings too small, and the airplane would lose performance and would not be a very, let's say, competitive offering.

Now, if we think about stretching the 195 but also re-winging the 195 and, in the process, putting some larger -- new-generation engines that could be -- how much larger fan? That will depend a lot on the tradeoff of should we try to raise the airplane a little bit or not. We do have some more potential to increase the size of the fan with the existing attitude of the airplane, attitude on the ground. If you re-wing the aircraft, then we can also play with the pylon and raise the pylon to raise the engine a little bit to get a few more inches in the fan.

So these are tradeoff studies that are underway as we speak. But let's say a 195, larger than the existing one today with the proper level of thrust and with the larger wing is an airplane that would be, size-wise, between the two C-Series, the 100 and the 300, probably. Yes. I would say in between; it depends on how much larger it is. And it would be a very competitive offering in our point of view. So this is one alternative.

The other alternative would to really try to go to a larger aircraft by having a, very likely, fiberglass configuration, where we would have full freedom to define the size and the optimization of the aircraft; again, keeping either -- keeping as a design driver a high degree of commonality with the existing E-Jets as far as systems architecture and cockpit configuration, et cetera. So it is more or less--

I'm not sure I fully answered your question, but these are the thoughts that we are having now.

Q - Noah Poponak {BIO 16071528 <GO>}

Is it fair to say that you are leaning towards a re-engine over a clean sheet, just given that both of the bigger guys are now coming down into that low end of the narrow-body market with a re-engined aircraft, which makes it look pretty crowded? But those are

temporary solutions for them. So you'd still be able to do a clean sheet further down the road, once those are rolling off for Boeing and Airbus.

A - Frederico Curado {BIO 2004589 <GO>}

No. I would not conclude that at all.

Q - Noah Poponak {BIO 16071528 <GO>}

Okay.

A - Frederico Curado {BIO 2004589 <GO>}

Both alternatives are pretty open for us. On the Airbus side, it is more clear to us that this is not just an interim solution; this is their strategy for some time. And as I have no visibility in exactly what is Boeing going to do with the (inaudible), we do not know. But no. I think we can go either way and have a competitive aircraft in the 319, 727-700, CS-300 area. And again, we have those two alternatives. We are fine-tuning the analysis. But I would not lean towards any at this stage (inaudible).

Q - Noah Poponak {BIO 16071528 <GO>}

Okay. I understand. And there's one other thing I wanted to ask you today, and then I'll jump off, and that is -- I wonder if you think there is a disconnect between where some market observers think the 90-seat market is going in the medium to long term and where you think it's going. Because as we are out discussing Embraer with investors, we often hear concern that the world's getting bigger, every airline wants larger aircraft. What's the future of the 90-seat market -- and a lot of concern on that. And at the same time, you have just absolutely incredible demand, and, actually, demand for the 190 relative to current production is, really, stronger than any other aircraft in the world right now. So is there anything you can tell us to get folks more comfortable with the medium; to long-term future of that market?

A - Frederico Curado {BIO 2004589 <GO>}

Yes. If that discussion was about the 50-seat market or even the 70-seat market, that would be an object of debate. The 50-seat market had been -- was developed in jets. It was developed in a great sense due to the scope clauses and all that -- 70-seater also. If the scope clauses moved towards some larger aircraft, 85, 90 or something, yes, that's going to create so much future demand there.

But the 100-seat market has been around since World War II. There is a market. There is a segment of the market which is there. Then the size varies. The number of aircraft in that segment varies. Frankly speaking, not many companies were successful in making a return in that market -- the 727-100, for example. The DC-9 was there for many years. The Falcon 100, the BAE 100, and, if you go even back in history, the Caravelle, et cetera, et cetera.

Now, we do not believe that the entry-level airplane in the airline market will be 130; or 150-seater. We do not see that happening at all. So we do not think that the larger portion

of the market will be the 100-seat.. It will be probably towards -- the medium of the narrow-body market is probably leaning towards 175, 180.

But there will always be a market there in this 100-seat segment. So we are leaders there now, and we'll keep investing to stay there. The 190s are a great platform as far as the fuselage, as far as it's a very modern airplane. So yes, of course, ten years from now, a 190 would not look like the 190 today. But I am absolutely convinced the 190 will be there in ten years from now, and will be leading its market.

If the scope clauses move upwards, that's wonderful. Then we'll have a boom of demand for 100 seats. If it doesn't, it is what we have today. So imagine that the first smallest airplanes out there is going to be a larger 150-seater, the assumption will have to be the network of the airlines will have to shrink significantly, and thousands of markets would have to lose service, which I think is a doomsday assumption. I don't see that happening.

Q - Noah Poponak {BIO 16071528 <GO>}

That's very helpful. And I apologize to you and to others if I was disruptive to the Q&A there, but thanks very much for taking my questions.

A - Frederico Curado {BIO 2004589 <GO>}

Thank you. I apologize for this technical issue that we also here were -- we had no idea what happened.

Operator

(Operator Instructions) This concludes today's question and answer session. I would like to invite Mr. Curado to proceed with his closing statements. Please, go ahead, sir.

A - Frederico Curado {BIO 2004589 <GO>}

Thank you, all, for being with us. Sorry, again, for this technical disconnection. I have no idea what happened.

But a good quarter, and we'll keep working hard to keep delivering on our results. Thank you very much. Have a great weekend, all.

Operator

That does conclude Embraer's audio conference for today. Thank you very much for your participation. Have a good day, and thank you for using Chorus Call.

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