

Q4 2015 Earnings Call

Company Participants

- Eduardo S. Couto, Director of Investor Relations, M&A and New Businesses
- Frederico F. Curado, President & Chief Executive Officer
- Jackson Medeiros de Faria Schneider, Executive Vice President-Defense & Security
- José Antônio de Almeida Filippa, Executive Vice President, Finance and Investor Relations (CFO)
- Paulo Cesar de Souza e Silva, Executive Vice President, Commercial Aviation

Other Participants

- Cai von Rumohr, Analyst
- Darryl Genovesi, Analyst
- Derek Spronck, Analyst
- Gustavo H. Gregori, Analyst
- Joshua Milberg, Analyst
- Myles Alexander Walton, Analyst
- Peter John Skibitski, Analyst
- Stephen Trent, Analyst
- Turan Quettawala, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good afternoon, ladies and gentlemen, and welcome to the audio conference call that will review Embraer's Fourth Quarter 2015 Results, 2015 Annual Results, and 2016 Guidance. Thank you for standing by.

This conference call is being held during the Embraer Day in Brazil, with the presence of investors and market analysts. At this time, the company will present its Fourth Quarter 2015 Results, 2015 Annual Results, and 2016 Guidance. Afterwards, we will conduct a question-and-answer session and instructions to participate will be given at that time. As a reminder, this conference is being recorded and webcasted at ri.embraer.com.br.

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 believe, may, will, estimate, 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. José Filippo, Chief Financial Officer and IRO; and Mr. Eduardo Couto, Director of Investor Relations.

I'll like now to turn the conference over to Mr. José Filippo. Please go ahead, sir.

José Antônio de Almeida Filippo

Okay. Thank you. Good morning and good afternoon. Welcome to Embraer financial results call. As usual, we're going to go through the presentation, and after that we'll be open to questions from the audience here and also from people outside.

So I'd like to start with the presentation, page three, with the financial highlights for the year. We had, as we anticipated in some quarters before, our record-ever backlog of \$22.5 billion in the end of the year; a free cash flow generation year of \$178 million; a net cash position as of December of \$7.2 million; and revenues of \$5.9 billion.

Also, we had an important non-recurring event, which was the filing of Republic Airways Chapter 11, which led us to record a provision of \$101 million that impacted the results. We'll do more details during the presentation, and we show the figures also with and without that impact.

In terms of result, we reported an EBIT of \$332 million, with margin of 5.6%. Adjusted for the Republic impact, it would be \$432 million and a 7.3% margin. In terms of net income, reported \$69.2 million of profit; and without the Republic, \$372 million.

Moving to next page, starting the highlights for each business units, and first, Commercial Aviation for the year 2015. We had a delivery of 101 E-Jets and net firm orders for 155 airplanes in 2015. This returns into a book-to-bill ratio of 1.5x, very important for the company as a big highlight for this business.

We added new operators in 2015. And also, in the end of the year, we reached the trademark of over 1,700 aircraft delivered in the E-Jet program. Also, an important milestone of the E2 development program was the rollout of the first E190, which happened last week.

FINAL

Next page, still in Commercial Aviation but more focused on the fourth quarter. We had the delivery of 33 E-Jets in the quarter, including the delivery of the aircraft number 1,200 for Azul. Regarding new orders, we had the SkyWest order for 19 E175 that will fly for Delta and the two options confirmed by KLM Cityhopper, which were actually confirmed in the last quarter.

We're also finalizing the highlights of the Commercial Aviation. Another information related to the E2 development was the successfully started off the flight test of the new engines.

Moving to next page, highlights for Executive Jets in the year. In 2015, we delivered 120 Executive Jets, broken by 82 light and 38 large jets. And as also we had in the Commercial Aviation, the book-to-bill ratio was very positive as well there. We had a 1.1x ratio in 2015 book-to-bill for Executive Jets.

Regarding our programs, the Phenom 300 was again the most delivered aircraft in the Executive Jets business in the year. This is now two years in a row of that performance.

Finalizing the highlights for Executive Jets, the program of the Legacy 500 and 450, we had the certification and entry into service of the Legacy 450 in the end of 2015, which we delivered three last year.

Next page, in terms of the fourth quarter, had delivery of 45 Executive Jets: 25 light and 20 large. In terms of commercial activities, we had the order for Emirates Flight Training Academy for up to 10 Phenom 100 and also the delivery of two Lineage 1000 in the U.S. market.

Also in the fourth quarter, as we mentioned, the Legacy 450 entered into service, and we're able to deliver three aircraft in that quarter.

Next page, Defense for 2015. Regarding the KC-390 program, first flight of the KC-390 happened in the early last year. It was in February. And now, this plane is in certification process, over 100 hours of flight in this process.

In terms of commercial activities, we reached 15 deliveries of the total of the 20 orders for the United Air Force - U.S. Air Force, 11 of those delivered last year. Regarding the Gripen program, we already started the works in Brazil and Sweden, and we now have 46 engineers working in Sweden in the preparation of the program.

Finalizing the Defense highlights, the Sisfron Project advanced and reached over 50% of execution.

Next page, fourth quarter for Defense, an important order of six Super Tucanos for the Lebanese Air Force. And in relation to the Defense programs, Atech completed its first phase of air traffic management system to be implemented in India. And the Brazilian geostationary satellite began the integration and testing phase.

Bloomberg Transcript

Concluding the highlights, the UK Armed Forces selected Phenom 100 to train their crew.

Okay. Now, with that, we close the highlights and we enter in the financial results, starting in page 11 with the backlog. As we already mentioned, we have the \$22.5 billion in the end of December, a record-ever for the company in a year-end position. That can be broken by 7% (sic) [70%] (10:00) of that amount related to Commercial Aviation; 21% related to Defense; and 9% for Executive Jets.

Next page. As far as deliveries, we had already mentioned, there were 101 deliveries for E-Jets in the year and 120 aircraft delivered in Executive Jets, broken by 82 light and 38 large.

Next page. Net revenues reached a total of \$5.9 billion in 2015, within our guidance range.

In your next page, spot on here a bit more details on the revenues break down by segment and region. In terms of segment, the reduction in Defense revenues was related to the dollar appreciation in 2015 and now represented, last year actually 13% of the revenues from 23% in 2014. We saw participation of 56% of Commercial and 30% of Executive Jets in terms of the revenue breakdown. When you go to the right side of this page, by region, the highlight, you see 65% delivered to the North American market base related to the orders and deliveries to United States.

The next page, revenues by segment. Our business reported the revenues within the guidance range, but the negative highlight was the Defense revenues as we mentioned before, due to the weaker Brazilian real that produced its participation here. Basically, this is the breakdown by segment.

Next page, just to SG&A expenses (12:14). SG&A expenses, page 16. A positive reduction reported in 2015 in both U.S. amount in percentage of net revenue, reaching 9% of revenues in 2015. And that confirms our focus and the commitment to really reduce the cost and take the opportunity as we can in terms of adding value and creating positive results for the result in terms of expenses and costs.

Next page, page 17. Just the information broken by quarter, the SG&A expenses, and we see how it worked. It's almost the same trend throughout the year in Brazilian reais and in U.S. dollars.

Next page, page 18. And here's to elaborate a little bit more because of the impacts that we had here. We reported a total of \$332 million with a margin of 5.6%. December was negatively impacted by a non-recurring event of the mentioned Chapter 11 of Republic Airways. And excluding that amount, the EBIT would have been \$432 million with a margin of 7.3%.

But also, as we've been indicating and we mentioned that when we reported the third quarter results, there were risks that could prevent us to reach the guidance range by year end. Already in that moment we indicated that we will be targeting the lower end of

the range. And in fact, those negatives impact actually happened, which were the impairment of used aircraft coupled with the cost base revision in Defense due to the devaluation of the real in the end of the quarter, especially in the middle of the last quarter of last year. If we take those effects out in a pro forma basis, we would have been reporting EBIT of \$494 million and a 8.3% margin in 2015.

Next page, in terms of EBITDA. The reported amount of \$648 million, with a 10.9% margin. Excluding the non-recurring Republic effect, that amount would have been \$749 million with a 12.8% margin.

In terms of net income, next page, page 20, we reported a \$69 million net income, with a 1.2% margin. Here the two important effects that we would like to detail and adjust on the calculation. The first event was the Republic effect, as we already mentioned. And the other was the devaluation of real that caused us to have deferred income tax. While we had that in previous quarters, but in this quarter we also had and the combination of everything return into the year impact. So if we return to those non-recurring effects, the net income would be \$272 million with a 4.6% margin.

Next page, earnings paid for ADR reported \$0.38 per ADR with a 49% payout, as we've been anticipating by quarter dividends because of the adjustment in the end of the year for the Republic effect. It returned from a higher payout, which was 49%. But if we adjust for the Republic non-recurring effect, the earnings per ADR would be \$1.49.

Next page, page 22. In relation to investments, we had a total of \$518 million in 2015, broken by; \$42 million research, \$288 million development and \$188 million in CapEx. The weaker real was the main reason for the reduction compared to our guidance, as we already continued the programs and investment phase of the programs as we expect.

Next page, 23, free cash flow. We had a positive free cash flow of \$178 million in 2015, primarily due to the strong cash generated in the last quarter as a consequence of lower investment and working capital reduction. So that allowed us to have in the total year \$178 million, which \$895 million generated by operating activities, \$290 million negative of additions to PP&E and \$428 million intangible assets additional negative due to the investment in the programs or development of our programs.

Next page, before we talk about the guidance 2016, our capital structure. We reported a net cash of \$7 million in December 2015 coming from net debt in previous quarters. In relation to our debt, it's still very comfortable and adapted to our profile, which has a maturity average of 6.2 years.

With that, we finalized the results and we now get into the presentation of the 2016 outlook. Page 26, outlook for revenues. Consolidated revenues estimated in the range of \$6 billion to \$6.4 billion, which includes Commercial Aviation, \$3.45 billion to \$3.65 billion in 2015; Executive Jets, \$1.75 billion to \$1.9 billion; Defense, \$0.70 billion to \$0.75 billion and other revenues, \$100 million. That sum up to the \$6 billion to \$6.4 billion. In terms of percentage, that represents 57% to Commercial, 30% for Executive and 12% Defense.

In terms of deliveries for Commercial Aviation, we estimate deliveries in the range of 105 to 110 E-Jets in 2015 and in terms of Executive Jets, 115 to 135 airplanes, broken by 75 to 85 light jets and 40 to 50 large jets.

The next page, operating results and investments. Our forecast for EBIT the range of \$480 million to \$545 million, with an EBIT margin between 8% to 8.5%. In terms of EBITDA, the range of \$800 million to \$870 million, with an EBITDA margin from 13.3% to 13.7%.

The free cash flow is expected to be a use of less than \$100 million and regarding investment, a total of \$650 million, broken by \$50 million in research, \$325 million in development, and \$275 million in CapEx.

With that, we finalize the presentation, and now we're ready for the questions. We will open now for the audience first, but the people outside they can also put their questions in and we're ready to answer. Thank you.

Q&A

Q - Myles Alexander Walton {BIO 6802513 <GO>}

Thanks (21:19). Myles Walton, Deutsche Bank. Could you touch on the margins in the fourth quarter by segment, in particular within the area that seemed to be the biggest surprise, Business/Executive Aviation? And touch on what the effect is of any trade-ins and kind of what the underlying clean margin would have been in Executive Aviation?

A - José Antônio de Almeida Filippo

In terms of margin for 2015, we had 10.4% in Commercial, 3.4% Executive and negative 11.5% for Defense. It's good to recall that Commercial Aviation already reflect the impact of the Republic provision. So without the Republic provision, Commercial would report 13.4% margin.

Q - Myles Alexander Walton {BIO 6802513 <GO>}

So, the question was on the Executive Aviation at 3.4%. And I imagine that means in the fourth quarter it was pretty low. Can you touch on what's driving that in the fourth quarter?

A - José Antônio de Almeida Filippo

Yeah. In the fourth quarter, we had a situation where we had a number of trade-ins larger than we normally have that impacted, because some of those trade-ins were most of them not our aircraft, so we had that situation in that quarter. So, when we sold those used aircraft and recorded – also the recorded impairment of them that return in the end of the year provision item. So, that's mostly what impacted the last quarter of Executive Aviation.

A - Frederico F. Curado {BIO 2004589 <GO>}

Myles, to your question, we had this glut of used aircraft many of them were not Embraer-made. We prioritized in the reduction of inventory and cash generation. Operating margin, Eduardo, I think it's close to zero in the Executive Aviation in the fourth quarter?

A - Eduardo S. Couto {BIO 18009973 <GO>}

About 0.5%.

A - José Antônio de Almeida Filippo

Just to clarify the margins per business for the quarter, we had 6.3% margin in Commercial Aviation. That includes the Republic impact. If we exclude the Republic impact, EBIT margin for commercial was 15.3%. On Business Jet, the margins were 0.5% in the fourth quarter. On Defense & Security, minus 5.5%. Consolidated margins, 3.2%; excluding Republic, 8%.

Q - Myles Alexander Walton {BIO 6802513 <GO>}

Okay. Just to wrap up that line of questioning, what's left in your glut of non-Embraer aircraft in inventory that you have to liquidate? And what's implied in your 2016 guidance for the business jet margin profile?

A - Frederico F. Curado {BIO 2004589 <GO>}

Yeah. I think we pretty much got rid of - if I may use this term, used aircraft. I would not know by heart how many airplanes we have in inventory, but it's much, much lower than what we had because as we concentrated the deliveries in the fourth quarter, we had this concentration also of the trade-ins and we decided to move them quickly.

Looking towards 2016, our guidance - I mean, we have historically resisted market share versus margin. So, we always favored margin and cash generation vis-à-vis market share. So, implicit in our forecast for next year we probably could think about a little bit higher volume. We believe the volume that we are setting is more adequate to resist the pricing pressure, which there is out in the market.

So, combination of better organized ramp-up - a relatively lower than what could be volume - it's going to be higher than 2015 anyway but maybe somebody could argue it could be a higher volume. That would give us pricing power. That would give us more resilience against the pricing pressure and also trade-ins, which, in the end, historically the last several months have shown the secondary market to be a little bit depressed.

I would just add that we still are positive on the U.S. market which is the market which fundamentally is demanding Executive Jets right now. What we have seen in these first 60 days of the year is due to the volatility of the markets we have seen a delay in decisions of acquisition of our Executive Jets aircraft. Is that something - is that a trend? Maybe not, not necessarily. But...

(26:23-26:56) our skyline. I can tell that it was better than what we had last year. But in the fundamental there is for us to have a better start in 2016 in the Business aircraft market.

Q - Joshua Milberg

Hi, Joshua Milberg, Morgan Stanley. Thanks for the question. I was hoping you could give your perspective on what the future holds for Republic and perhaps what the larger (27:30) Chapter 11 could be for the overall regional low-cost market in the U.S.? And one main concern that we have is that potential part of its existing fleet of (27:42) could eventually make it to the market (27:45).

A - Frederico F. Curado {BIO 2004589 <GO>}

You mean the E-Jets or the 145s?

Q - Joshua Milberg

E-Jets.

A - Frederico F. Curado {BIO 2004589 <GO>}

E-Jets. Okay. Paulo, you want to take this? I can do that, but...

A - Paulo Cesar de Souza e Silva {BIO 17023173 <GO>}

Okay. (27:58) So we see the regional aviation market in the U.S. So it's very strong right now. Of course, after the changes in (28:14) and strong consolidation that happened in the last few years. So (28:28-28:48) from the majors, especially American and Delta. And then we have smaller players being important players also, TSA (29:02) St. Louis. So, the major airlines, it do depend upon the regional airlines advice (29:12) for flying. So, I think it's definitely an important part of their business model to buy CPAs from the regional airlines to fly smaller jets. So, regional airlines fly regional jets, smaller jets, much more efficiently than the majors would do. So that is an integral important part of their business plan.

Regarding Republic, my take on Republic is that they are very important for American, for Delta, and for United. Republic nowadays operates about 250 aircraft. When we talk to the three major airlines, so they like Republic, they believe Republic, they have a very good service. And they very - they have, I would say, a cost structure which is okay. Of course, now they will have to renegotiate the CPA given the pilots issue, right? But the pilot issue, the pilots, I would say, the pilot requests for increasing salaries, so this is not only the regional airlines so this is across the board in the USA given that airlines are making money right in the U.S. now.

So, apart from that, Republic has a very good service, very good reliable flight (30:58) service and Republic is very important, so it has a meaningful business for these airlines. So, I believe Republic do survive. I believe, I don't exactly which format Republic will take advantage going forward. But I believe Republic will be a survivor, given the importance of Republic in the (31:22) system.

I also believe that same consolidation in the regional airlines in the U.S. may be necessary. So going forward, so we are seeing the majors very strong, very strong, and we are

seeing some regionals not very weak but somehow little bit in need of muscle in order to negotiate, be in a better position to negotiate with the majors.

Q - Joshua Milberg

Thanks very much. A related question, pertains to your mix on the commercial side. You didn't have a very good evolution in terms of your E175 that we saw decline in your E190s and E195s and I was just - could you give us some sense of, first half, what's built into your numbers, your forecast for 2016 and when we might see a recovery in demand for the E190s and E195? Thanks.

A - Frederico F. Curado {BIO 2004589 <GO>}

For 2016, so the book of our deliveries will be in the United States, it's regarding the 175, of course. There will be also some 190s, 195s outside the U.S. but by far the book will be in the U.S. We are seeing good demand for the 190, 195 outside the U.S. We are involved in a lot of transactions that involves these two right (33:00) types. And we are - I mean, for both, right E1s and E2s. So when we look our sales last year 176 aircrafts were sold last year, right? So, when we look at that, so we see a very good combination of our 190s, 190 family and the 175, also good combination of E1s, E2s, so I think we continue to see a good market, of course a good market for our market size, right. So we are talking about the segments between 70 and 130s.

Q - Turan Quettawala {BIO 6362141 <GO>}

Thank you. Turan Quettawala from Scotia Bank. My question is on the D&S segment. I'm just wondering, what the total cost base revisions were in 2015 on that segment? What the BRL assumption rates for 2016, and I guess how do you expect the cost base revisions to flow through in 2016?

A - José Antônio de Almeida Filippo

Yeah. In terms of 2015 it was about \$130 million impact. As we said, it was not the only impact there. This is one of the major of course. There were, of course revision of the problems that we had last year. For this year, this cost growth which is the devaluation of the Brazilian Real although is still we cannot anticipate, but we don't see the volatility that we had last year. So, maybe this still be something that we have to consider and to be aware of, but we don't expect to see in that situation that we had last year. It's more now to really focus on the development of programs and cost in terms of discipline, in terms of cost. It's more likely we see - I think the problems are already adjusted for the base (35:09) that we agree with the customer in that case, so basically that's what we'll expect to see this year, the same situation.

Q - Turan Quettawala {BIO 6362141 <GO>}

So, the cost base revision is zero in your guidance, embedded in your guidance?

A - José Antônio de Almeida Filippo

Yes. Yes, that's - we work on the flat exchange rate. Yeah.

Q - Turan Quettawala {BIO 6362141 <GO>}

Thank you.

Q - Stephen Trent {BIO 5581382 <GO>}

Good afternoon, guys. And thank you for the time. It's Steve Trent from Citi. Just one or two questions if I may. First is, I was wondering in the Commercial segment, are you seeing any shift, so to speak, when you think about your competitors with respect to the amount or maybe undue (36:01) amount of how some of your competitors are getting from their home governments. And I'm wondering if you've noticed any difference in that over the last year? And that's my first question.

A - Frederico F. Curado {BIO 2004589 <GO>}

Some competitors, one specific, they're not on hemisphere. Yeah, of course we're watching that closely, I mean, following that we do not have any other information other than what we read in the press. It is, of course, a matter of concern that an artificial imbalance may be introduced in the marketplace. We, of course, are not in a position to say that the state aid that's being done inadequate or inadequately, we have to wait and see. If it is equity as we have seen probably something within the framework of the WTO, Brazilian government is already following up this development. And there has been great discipline since the panels (37:11) in the last decade, which affected Brazil and Canada, but also it was followed by U.S., Japan also signatory of the ASU, Aircraft Sector Understanding.

So we have not seen in the last several years, probably a decade, any disrespect to sales finance. What we see now, a \$2.5 billion investment is something new, we are watching. And you may recall, our last capital increase was back in year 2000. So we have not increased our capital for the last 16 years. We have fundamentally financed our development, our strong R&D and CapEx with cash generation of the company and that's how we plan to continue to do.

Q - Stephen Trent {BIO 5581382 <GO>}

Great. Thank you very much, Freddie. And just one other question for now. When I think about the Defense segment and what seems to be very successful deployment of the A-29 programs by the United State in Afghanistan, to what degree do you think there is possibility that other foreign militaries are maybe taking look at the products?

A - Frederico F. Curado {BIO 2004589 <GO>}

Yeah. I absolutely - yeah, we are very bullish on A-29. A-29 is a Super Tucano, very bullish. This aircraft has been, I think very well specified. The spec was very good done by the Brazilian Air Force, I think Embraer also did a good job in developing and producing a superior aircraft for that mission. The U.S. Air Force is a huge endorsement to the product. So the first collateral results of our 20 aircrafts ordered for the U.S. Air Force, out of which how many have you delivered at Jackson, 16?

A - Jackson Medeiros de Faria Schneider {BIO 15326024 <GO>}

15.

A - Frederico F. Curado {BIO 2004589 <GO>}

And we have, I think 8 already in Afghanistan, delivered Lebanon order, so that came as a result of that operation in Jacksonville. The airplanes will be produced also in Jacksonville. So there is second trench, second batch for the U.S. Air Force which we hope maybe completely confirmed. We don't have that information yet but that's our expectation. And we believe that out that facility, out of Jacksonville we may actually have a strong export because for the wrong reason and unfortunately the world has had more and more conflicts which are typical of requiring aircraft of that size and that agility and that low cost, also. So, yes, we are bullish on the - Jackson, in his presentation, will detail how spread our customer base is becoming in the A-29.

Q - Stephen Trent {BIO 5581382 <GO>}

That's very helpful. I'll get back in the queue. Thank you very much.

A - Frederico F. Curado {BIO 2004589 <GO>}

Okay.

Q - Peter John Skibitski {BIO 6760095 <GO>}

Pete Skibitski, Drexel Hamilton. Just curious how conservative you feel your free cash flow guidance is for 2016? If the real stays where it is, is there another opportunity to undercut on the development expenses? And if you can manage working capital again, is there an opportunity to outperform on free cash?

A - José Antônio de Almeida Filippo

Yes. I think that what we saw in 2015 was the phase of the investment was pretty much related to the labor and the engineering phase, so we benefited. The exchange rate helped a lot without affecting the development capacity. I think that there's still an opportunity that we may have. However, now we enter in different phases of the development, more related to dollar denominated costs of the development. So, I don't think this will be something that could be very clear that's going to be impacting. But you have to understand the difference between what we faced last year and this year following phases of the development.

A - Frederico F. Curado {BIO 2004589 <GO>}

Maybe just following up on that question, probably to the benefit of everyone. We have assumed a flat exchange rate of BRL3.9 per dollar, so the plan that you see in front of you has this assumption.

Q - Peter John Skibitski {BIO 6760095 <GO>}

Is there any remaining cash payments on the KC-390 or other Defense programs that you are still awaiting from the Brazilian government? Or is that customer caught up in all the payments that are expected?

FINAL

A - Frederico F. Curado {BIO 2004589 <GO>}

Not all. But we have, as we said mid last year, we would make a strong effort not to let the accounts receivable increase, and we did that. Actually, I think there was a little bit of a decrease. But it was still a large number there in our accounts receivable from - owned by the government. So, this first 60 days we did receive payments regarding the KC-390. We, of course, are aware of the increasing difficulties of the Brazilian budgets, a recent announcement of a further cut in the budget which we do not know whether or not it's going to affect our programs. But we are much more prepared to face this situation now than we were, let's say, 12 months ago when we were really hit without much advanced notice.

So, again, what we have presented represents a BRI3.9. If the real further devaluates to BRI4, BRI4.5, of course that's going to impact the Defense business again, but probably to a much lower extent than we anticipated we had last year.

Q - Peter John Skibitski {BIO 6760095 <GO>}

If I could sneak one last in on segment margins. In 2016, Commercial seems to be doing really well even at a worse mix for the 175s. I'm just wondering kind of what you are assuming in your EBIT margin guidance in biz jets, and especially Defense? Are we assuming breakeven on Defense in 2016 or just wondering with the calculations (43:50) there?

A - Frederico F. Curado {BIO 2004589 <GO>}

Yeah. I think probably, we can think about the commercial jets, again, pulling the average upwards, probably again, low double digits for Commercial. Defense from low to mid one digit margin and Executive Jets from mid to high single digits margin, that's roughly where we would expect averaging out this 8.5% that we already represented.

A - Eduardo S. Couto {BIO 18009973 <GO>}

Maybe if we have some questions from the broadcast?

Operator

Certainly. Thank you.

A - Frederico F. Curado {BIO 2004589 <GO>}

Go ahead.

Q - Gustavo H. Gregori {BIO 16209398 <GO>}

All right. Yeah, this is Gustavo Gregori from HSBC. I have a quick question regarding the backlog. Given everything that's going on with Republic, do you believe that there is any risk in terms, going forward, that we could end 2016 perhaps with a decrease in the backlog, or do not see any risk? And furthermore, second part of the question would be,

is everything that's going on, does that create any risk in terms of deliveries looking forward for 2017 while you're trying to bridge the gap between E1 and E2?

A - Frederico F. Curado {BIO 2004589 <GO>}

Paulo?

A - Paulo Cesar de Souza e Silva {BIO 17023173 <GO>}

Yeah. The first part of the question on Republic and deliveries backlog. So, we have this year 9 deliveries to Republic from August to December and we have 15 additional next year and all of them in connection to a contract, a CPA agreement between Republic and the United Airlines. So, United has a big need for this aircraft. So it's being said already by United to us that they do need these aircraft. So being Republic or being other regional airline, so we believe that we will deliver these aircraft. So still a little bit early stage to say what will be the structure, the format because the Chapter 11 was last Friday, right, but we are working on this now. And as the next delivery is in August only, so we have enough time to structure something. But I'm very, I'd say, confident that these aircraft will be delivered given the need that United has right on them.

A - Frederico F. Curado {BIO 2004589 <GO>}

I think it's fair also to add that Republic has already represented to us they do want the aircraft. The question is whether or not, which format we will be able to deliver. But I think that the first question was related to that. We do not see airplanes exiting the Republic fleet. Actually we do not see them even waiving the deliveries that they have in backlog. So, we really believe those airplanes will be delivered, hopefully to Republic. But if not, I think other alternatives will show up because the airplanes are meant, they are packaged (47:35) to fly for United and American - in this case, just United, but also American in other part of the country. Hello?

A - Paulo Cesar de Souza e Silva {BIO 17023173 <GO>}

Yes. It's important to mention that Republic restructuring is all about the 50 seater, so it's not at all about the 76 seater. So there will be a single aircraft operator going forward. That's where they find that would be more rate efficient going forward, now given the pilot issue. So flying a slightly bigger aircraft.

Q - Gustavo H. Gregori {BIO 16209398 <GO>}

All right. Thank you.

A - Frederico F. Curado {BIO 2004589 <GO>}

Now, we are going to take a question from the phone.

Operator

Certainly. Thank you. Our first question comes from the line of Cai von Rumohr from Cowen & Co. Please go ahead.

Q - Cai von Rumohr {BIO 1504358 <GO>}

Yes. Thank you very much. So, Fred, you said you expect double digit, low double-digit margins in Commercial. But looking at your guidance, it looks like the margin would be down in Commercial from the 13.4% in 2015. You had very good margins in the fourth quarter. You look for higher deliveries and you say the mix is about the same. Why are the margins down? Are you assuming any residual value guarantees in there or why do they appear to be lower?

A - Frederico F. Curado {BIO 2004589 <GO>}

No, not RVG, probably a mix. We still had in 2015 some E190, E195 contracts, which helped to boost the margin up. So, I think it's fundamentally mix. Paulo, any other specifics?

A - Paulo Cesar de Souza e Silva {BIO 17023173 <GO>}

No, that's it. It's basically about mix. So not only more E190s, E195s in 2015, but also very good margins in certain specific deliveries.

Q - Cai von Rumohr {BIO 1504358 <GO>}

Excellent. And then the last one. You talked a little bit more in your release about the FCPA investigation and your negotiations with the DOJ. Is it your hope and expectation to kind of resolve that matter in this next calendar year?

A - Frederico F. Curado {BIO 2004589 <GO>}

We don't really have any specific comments. Hope, yes. Expectation, no. I mean, we cannot have any expectation. We have to abide by the disclosure that we have made. So, only thing we can keep collaborating in full and waiting for the results.

Q - Cai von Rumohr {BIO 1504358 <GO>}

Terrific. Thank you very much.

Operator

Thank you. And your following question comes from the line of Darryl Genovesi from UBS. Please go ahead.

Q - Darryl Genovesi {BIO 20862546 <GO>}

Hi, guys. Thanks for the time. Just looking at your margin profile from 2015, I think you said excluding the used inventory charge and excluding the adjustment of the Defense business, you did about 8.3% EBIT margins in 2015. And your guidance overall would embed a relatively flat margin profile in 2016 from that level. And just wondering - I mean, if you're counting on a real at 3.9 reais per dollar, which is where we are today, that still embeds a 15% to 20% weakening relative to the average level from 2015. And just wondering why we're not seeing any incremental margin upside as a result of that?

A - Frederico F. Curado {BIO 2004589 <GO>}

Well, there's a combination of variables. Defense, for example, we are having a further reduction in activity. And, of course, the more we reduce income in the revenues, the harder it is to absorb the fixed costs. We just explained also about a slight reduction in the commercial jets although it's through (52:15) a robust two-digit margins. So the combination of - and we hope to have some recovery on the business jets.

So I think the effect of real is more pronounced in the cash flow, specifically on the R&D, on the, let's say, engineering part of R&D expenses. But as Filippo said, that also in 2016 we will have a higher dollar-denominated expense portfolio because of the (52:46) flight test campaign, tooling, et cetera. So, I guess, it's a combination of several different things.

Q - Darryl Genovesi {BIO 20862546 <GO>}

Thanks for that. Fred, just as a follow up, I mean, it may be a little bit bigger question on roughly the same topic. Historically, we've seen a very high degree of correlation between your EBIT margin that you reported and the real-dollar exchange rate. But that correlation seems to have broken down this cycle, not just in 2016, but basically since kind of 2008, 2009. Should we still think of you longer term as a beneficiary of a weaker real? Or does the downside at the Defense business essentially offset any gain that you get at the Commercial and Executive Jets business?

A - Frederico F. Curado {BIO 2004589 <GO>}

We really tend to look at exchange rate as a tailwind or as a headwind, not as a definition of our competitiveness. We are, for example, moving the whole assembly line of Phenoms to the United States, to a higher cost, labor cost environment, because we believe this makes all sense: strategic sense, supply chain logistics sense, risk, et cetera.

So we see our business as a global one. We see Embraer and its endeavor to become more and more a global company. And it's not by arbitrating labor costs which, as everyone knows, is not a significant part of the costs. The supply chain, the equipments is the significant portion of our COGS - of any OEM COGS. So that's how we see it. So, yes, the weakened real, it's a tailwind. It's welcome. It is not what defines our competitiveness. We have to be competitive regardless of a stronger or a weak real. We were in an upside situation three or four years ago and we were competitive, and we are now. But we have benefited, yes, from this devaluation.

Q - Darryl Genovesi {BIO 20862546 <GO>}

Great. Thank you.

Operator

Thank you.

A - José Antônio de Almeida Filippo

We'll come back to the audience here, a question. Okay. So, with that, I think it's time to finish this piece of the event today. So we'll be ready now to go to the presentation of each business unit. I don't know if I have to turn back to the phone there? Not yet?

A - Frederico F. Curado {BIO 2004589 <GO>}

Are we done with the conference call? We may have time for one more question.

A - José Antônio de Almeida Filippo

Yes. Maybe we'll take a final question and conclude the Q&A.

A - Frederico F. Curado {BIO 2004589 <GO>}

If there is one.

Operator

Thank you. We have a question on the phone and it comes from the line of Derek Spronck from RBC Capital Markets. Please go ahead.

Q - Derek Spronck {BIO 17904184 <GO>}

Thanks. Thanks for taking my question. When we consider your CapEx spend levels over the next few years, would you consider 2016 as the high point of your annual CapEx spend? The Legacy 450, 500 are now launched, and should we start to think about it coming down in 2017 and beyond?

A - Frederico F. Curado {BIO 2004589 <GO>}

With the current programs, probably. Maybe 2016 - maybe 2017 will still be significant. But probably right, probably right, under the existing programs.

Q - Derek Spronck {BIO 17904184 <GO>}

Okay. Thanks. And just quickly, on the KC-390, are you seeing any increase in international demand for that program?

A - Frederico F. Curado {BIO 2004589 <GO>}

We've seen a lot of interest, many air forces visiting and taking questions and getting acquainted with the product. The second prototype will join the flight test campaign very soon. The airplane is flying really well. I think Jackson is going to talk about it in a minute. So we're all set to go to have this airplane certified by the end of next year and start delivering units in 2018. So, so far, so good.

Q - Derek Spronck {BIO 17904184 <GO>}

Okay. Thanks.

FINAL

Bloomberg Transcript

A - José Antônio de Almeida Filippo

Okay. I think we have the last question here in the audience.

Q - Operator

Daniel Fontanella from SBVE (58:17). If you could talk about the cash flow generation in 4Q? So you have sort of a positive number, and you said that you reduced CapEx maybe by \$100 million. Was there any other effect that you could see? Thank you.

A - José Antônio de Almeida Filippo

Okay. Basically, the fourth quarter is the most active quarter where we have a lot of activity, commercial activity, and deliveries are concentrated if you take the split by quarters. So that is exactly what happened last year again. But that combined with - there's a combination of that with a lower investment, not that we didn't invest in terms of the advance of the programs. This is more like an opportunity because of the exchange rate that affected positively there. There was working capital gains as well that we realized there in terms of an advance from customers because of the sales increase. And we were able to reduce use of inventory if you compare to the end of 2014. So this was a good combination that we had. But basically, it didn't change in terms of the pattern that we see, which is more activity in the last quarter of the year. That's basically why you see a cash generation positive in the last quarter.

Q - Operator

Thank you.

Thank you. That does conclude Embraer's audio conference for today. Thank you very much for your participation. Have a good day.

This transcript may not be 100 percent accurate and may contain misspellings and other inaccuracies. This transcript is provided "as is", without express or implied warranties of any kind. Bloomberg retains all rights to this transcript and provides it solely for your personal, non-commercial use. Bloomberg, its suppliers and third-party agents shall have no liability for errors in this transcript or for lost profits, losses, or direct, indirect, incidental, consequential, special or punitive damages in connection with the furnishing, performance or use of such transcript. Neither the information nor any opinion expressed in this transcript constitutes a solicitation of the purchase or sale of securities or commodities. Any opinion expressed in the transcript does not necessarily reflect the views of Bloomberg LP. © COPYRIGHT 2022, BLOOMBERG LP. All rights reserved. Any reproduction, redistribution or retransmission is expressly prohibited.