

Q3 2002 Earnings Call

Company Participants

- Antonio L Pizarro Manso, Executive Vice President
- Frederico P Fleury Curado, Executive Vice President Commercial Airline Market
- Gustavo Poppe, Investor Relations Manager
- Mauricio N Botelho, President and Chief Executive Officer and Director

Other Participants

- Carmen Slade, Analyst
- Daniel Mcgoey, Analyst
- Emerson Leite, Analyst
- Gordon Lee, Analyst
- Heidi Wood, Analyst
- Nick Morton, Analyst
- Robert Spingarn, Analyst
- Rodrigo Pereira, Analyst
- Ron Epstein
- Ron Epstien, Analyst
- Rusty Johnson, Analyst.

Presentation

Operator

Excuse me every one. We now have Mr. Mauricio Botelho, Chief Executive Officer of Embraer along with Chief Financial Officer Mr. Antonio Louis Manso and Gustavo Poppe, Investor Relations Manager in conference. Please be aware that each of your lines is in a listen only mode. At the conclusion of the presentation, we will open the floor for questions. At that time instructions will be given as to the procedures to follow, if you would like to ask a question. This conference call includes forward-looking statements or statements about events or circumstances which have not occurred. We have based these forward-looking statements largely on our current expectations and projections about future events and financial turns affecting our business and our future financial performance. These forward-looking statements are subject to risk, uncertainties. And assumptions, including among other things, general economic, political and business conditions both in Brazil and in our markets. The words 'believe', 'may', 'will', 'estimate', 'continues', 'anticipate', 'intend', 'expect' and similar words are intended to identify forward-looking statements. We undertake no obligations to update publicly or revise any forward-looking statements because of new information due to 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. Our actual results could differ substantially from those anticipated in our forward-looking statements. I would now like to turn conference over to Mr. Botelho. Sir you may begin.

Mauricio N Botelho {BIO 13386065 <GO>}

Good morning, Ladies and Gentlemen. I am Mauricio Botelho, CEO of Embraer, it's a pleasure being (inaudible) with all of you. Thank you for joining our Third Quarter conference call to discuss our results in US GAAP that we released yesterday and a general overview of financial statements in Brazilian GAAP. I have here with me Antonio Luiz P. Manso, our CFO, Gustavo Poppe, our Investors Relations Manager and he is in the team (inaudible). And I think that all of you already know but -- basically to see that he has a beautiful daughter, he's still nurturing her and will be soon with us again. And at this point I pass the word to Gustavo who is going to make the brief presentation and then open for the Q&A session. Thank you. Go ahead, Gustavo.

Gustavo Poppe {BIO 15816981 <GO>}

Thank you, Mauricio. Good morning, everyone. We are webcasting this conference call with a slide presentation on our website at www.embraer.com.br on the Investor Relations section. And presentation should last only about 10 minutes and then we will open up for question and answers. During this quarter we delivered 30 aircrafts, the same as we did during the Second Quarter of this year. A total of 28 regional aircrafts were sold including 18 ERJ 145 and 10 ERJ 140. We also delivered two Legacy, one to the corporate aviation business and another to the governmental transportation business. Please note that the table included in our Third Quarter earnings release contains 33 deliveries during the quarter, as it includes three aircraft delivered to the C1 [ph] program. As you all know, these aircraft do not represent revenue when they are delivered. We maintain our forecast for this year of 135 aircrafts and expect to deliver 45 aircrafts during the Fourth Quarter. In October, we delivered already 14 aircraft as planned, including 8 ERJ 145 XR to Continental after the certification granted by FAA on October 27 -- 22nd 2002. The order (booked) for the ERJ 145 family includes 290 from backlog and 353 option, plus 587 aircrafts already delivered. The Embraer 170 and 190 family order (book) is stable, with a 112 firm orders and 202 options. It does not include the sales already announced to Alitalia and Jet Airways, which could add 16 firm orders and 16 options when the contracts are signed. On the next slide, we see the total financial backlog. We had two new orders for the Legacy and cancellation of ERJ 135 from South African Airlines, whose growth strategy did not evolve as planned. The sales to Jet Airways and Airtalia would represent an additional \$510 million in firm orders and \$410 million in options. The total backlog would be positively impacted by then \$920m. Reassessing our position, \$100 million were reclassified from defense options to firm orders, in comparison to the financial backlog we informed last month with no impact on the total amount. Our net revenues reach at \$581 million with a 1.5% reduction when comparing to Second Quarter 2002 sales. This difference can be attributed to a slightly different pricing computed in the commercial aviation, variations of defense and corporate sales related to the change in delivery of Legacys. And the effect of the Reais devaluation on customer services and other related business sales made in Reais in Brazil.

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Our sales had a similar diversification when compared to the previous quarter both in terms of segments and geographically. With our operations in Asia and future sale of the of the new EMBRAER 170 family, we plan to diversify geographically our sales in the future with growth in Asia and in Europe. Our EBITDA -- the EBIT presents a decrease of 6.7% in comparison to 2Q in 2Q02. And a marginal reduction of 120 basis points. This was due to the reduction in sales and slightly increased operating expenses primarily related to training and education.

Our EBITDA was impacted by the same factors as our EBIT and presents with similar performance. Our net income, however, presented a minor improvement when compared to Second Quarter '02 net income. This was due to the decrease in financial transaction loss related to the increase in the (inaudible) transactions, which dropped a larger part of our US dollar and Japanese Yen, denominated debt to Reais. These were partially compensated by the increase in provisions for income tax, which in fact had an effective rate of 61%. Most of the increase is related again to losses arising from the re-measurement of monetary assets and liabilities demonstrated in local currencies, which are unfortunately are not deductible for Brazilian tax purposes and other differences between US and Brazilian GAAP. And they will not represent such results in the future.

Our total accounts receivable increased this quarter as you can see on the graph. We supported the delivery of aircraft of certain customers that will conclude in their financing arrangements with six aircrafts. We expect this to be settled in a few months' time. Inventory decreased by 45.4 million between September 30 and June 30 of 2002. This decrease was related to ERJ 145 family inventory reductions partially offset by the development of the EMBRAER 170, which currently has six prototypes carrying out the flight certification campaign and also by the increase in delivery for the 4Q02, which demanded higher working capital.

Our net cash position decreased due to the effect of the Reais devaluation and increased working capital requirement. Of the total cash and cash equivalent balance of \$760.1m, 68% comprises investments in Reais. The remaining 32% primarily is in US dollars. The Embraer's cash investment strategy is based on the prospects for future investments, which were mostly denominated in Reais. This level of cash has enabled us to obtain long-term credit facilities even when considering the weak scenario. Embraer raised a 7-year working capital of \$100 million loan with a total all in cost of (liable) plus 3.9%, 150 basis points lower than the Brazil's present cost of capital.

Last year, we extended our indebtedness for five and as of September 30 -- I'm sorry, as of last year, we extended our indebtedness to five and as of September 30, 55% of our total investments was related to long-term financing in comparison to 40% as of June 30, with four years average maturity in comparison to 2.8 average maturity as of June 30. Our gross indebtedness is less than one time of our 9-month EBITDA, which is a very comfortable position. We partially, swapped our Japanese Yen and US dollar denominated to Reais related interbank interest rate CDI. And we now have 54% of a total debt in Reais at a weighted average cost of 15.5% per annum, equivalent to 86.8% of the CDI. The debt in dollar has a cost of 5% per annum. I think you all -- and would like to invite you for the Q&A session now.

Questions And Answers

Operator

Thank you, Sir. At this time, we will open the floor for questions. If you'd like to ask a question, please press the '*' key followed by the '1' key on your touchtone phone now. Questions will be taken in the order in which they are received. If at anytime you would like to remove yourself from the question in queue, please press "€œ" followed by '2'. Please limit your questions to one at a time. Again, to ask a question, press '*' key followed by the '1' key. Our first question comes from Heidi Wood of Morgan Stanley.

Q - Heidi Wood {BIO 3095506 <GO>}

Good morning. Nice quarter guys. A couple of questions for you Mauricio. And then one for Antonio Louis. Can you talk a little bit about the slots that are filled for next year? What are you projecting for diluted next year? And then what percentage of that is full? And then, if you can kind of go over with us by geographical segment, where you see future demand outlook if you break out US, Europe. And Asia, where do you see the orders to fill the remaining slots available coming from? And secondly, when you look at recent news, there has been two troubled Airlines, U.S. Airways and United who have been fighting that they would -- they're heading towards using regional jets. Can you discuss -- are you going to -- are you in discussions with other major airlines who might be similarly looking to make that transition, or where do you see that this is sort of a one phenomenon. And two can you talk about your willingness to use your balance sheet i.e. to selected customer financing? Actually, -- I will stop there and let you answer Mauricio.

A - Mauricio N Botelho {BIO 13386065 <GO>}

(inaudible) Hi. That's very good to hear from you. As I said it, 2002 -- we didn't change our prospects in that -- in respect to that operation next year, as well as we are keeping our position in respect to this year. There are things that may be very good. But we prefer to keep ourselves in a conservative stance today because there is a lot of uncertainty in the scenario ahead. So, we see us delivering next year 145 aircraft. In terms of the development of the business and where the market is going to develop stronger than now, we see that we are approaching the Asian market. We are -- now it is the third year that we are marketing our products in the region in a very strong position, I think. We are getting -- more and more goodwill and response from several airlines. And we are overcoming some natural lack of knowledge in respect not only of Embraer but in respect of our country (inaudible). I think that Asia will more and more be important in our operation. As you know, we are still negotiating with the Chinese government -- our joint venture in China. The prospects are very good. We feel more and more comfortable with the developments and we still think that it is feasible to have an agreement settled by the end of this year. So, I think that more and more you will see that Alitalia growing its importance in our operations.

Q - Heidi Wood {BIO 3095506 <GO>}

Thank you, Mauricio (inaudible)

A - Mauricio N Botelho {BIO 13386065 <GO>}

What?

Q - Heidi Wood {BIO 3095506 <GO>}

Thank you. What percentage of this -- of the 145 for next year you have filled?

A - Mauricio N Botelho {BIO 13386065 <GO>}

Well Frederico did you hear that?

A - Frederico P Fleury Curado {BIO 2004589 <GO>}

I thought she asked (our) rate is high.

Q - Heidi Wood {BIO 3095506 <GO>}

Very well Antonio Louis.

A - Antonio L Pizarro Manso

I believe, we spoke about the between 10 and of course (inaudible) 16 through the (inaudible) family. There are otherâ€¦.

A - Mauricio N Botelho {BIO 13386065 <GO>}

Go ahead.

A - Antonio L Pizarro Manso

And the 145 that we have the (inaudible) in vicinity of the 145, we'll have the -- its 5-9% more or less -- sorry-- the stock (inaudible) clearing is 5-9% and the spilt between the 145. It is 170, more or less its (inaudible) 15% for the 170 family.

A - Mauricio N Botelho {BIO 13386065 <GO>}

So, just to make clear 85-90% on the (inaudible).

Q - Heidi Wood {BIO 3095506 <GO>}

Okay so 85-90% of the 145 for next year is full still. Did I get cut off or you guys are still (inaudible).

A - Mauricio N Botelho {BIO 13386065 <GO>}

Sorry. I still have answers to give it you.

Q - Heidi Wood {BIO 3095506 <GO>}

Oh, Yes.

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A - Mauricio N Botelho {BIO 13386065 <GO>}

US Airways and United Airlines.

Q - Heidi Wood {BIO 3095506 <GO>}

Yes, exactly.

A - Mauricio N Botelho {BIO 13386065 <GO>}

Yes. They US Airways is still dealing with chapter 11 negotiation. I still think that they have very good chance to move on investor aspect and they say that by middle of the year, they would expect to have cleared the situation. I think that the order from US Airways is a very significant one. And for sure we'll be fighting strongly. We'll make that deal happen. But in any circumstance, we are not prepared to put our balance sheet to sustain that operation. We will be fighting very strongly but we'll be fighting on solid financial structures to support the deal. That's why we cannot do anything at this time. At this time, we are talking, negotiating, discussing about the products, the customer support, the operation but there is no financial structure presented because it's absolutely impossible to have figures discussion in that respect in the present moment -- at the present moment. So what I see is -- when I come back to my first point, is that there are uncertainties -- ahead of us. If these companies US Airways or United Airlines, they do not succeed in overcoming the present situation they are leaving, for sure, that there will be an impact in the market place but that's why we are seeing good things ahead of us. But we are also see threat. So we are keeping our position at this time that will be delivering 145 aircraft next year.

Q - Heidi Wood {BIO 3095506 <GO>}

Right. Thank you, very much and (in terms of your release), what do you project yearend net cash to be at?

A - Mauricio N Botelho {BIO 13386065 <GO>}

I believe it is almost the same you have today of around \$300,000 -- \$300m.

Q - Heidi Wood {BIO 3095506 <GO>}

Okay, thanks very much. I'll let somebody else ask some questions.

A - Mauricio N Botelho {BIO 13386065 <GO>}

Thank you.

Operator

Thank you. Our next question comes from Emerson Leite , CSFB.

Q - Emerson Leite {BIO 4003528 <GO>}

Hi. Good morning (inaudible). Good morning everyone. Well my question is still related to the financing outlook. I mean you said of (taking any two) consent with the balance which you finance the major orders. I think in spite of that and we saw again this quarter, I mean six aircrafts for in some kind of being financed by Embraer and I would like to understand what is your options, then (draw) financing structure for 2003 and then what will be the availability of private lines from the (BNDF) as well?

A - Mauricio N Botelho {BIO 13386065 <GO>}

The fact is that when we say that we are not going to put our balance sheet this means that we are not going to sell an aircraft for ourselves. What I mean is that every say that we have there is (structured) finance to support it. Eventually, in some circumstance there these structures are not able to be put in place as that put at the delivery time of the aircraft. As a consequence, we momentarily and temporarily can support the customer in that respect. This is quite different from -- situations where we saw companies that today are not alive anymore. They are selling aircraft for their leasing companies and at the very end they -- took money from one pocket to another and at the very end they failed and did not succeed. What we have seen today is exactly the situation that I have described. Some of our customer staff were not able to put together, (to close the) financial structure at the time of deliveries and then we assumed portion of it. But this is something that will disappear as the same way that the receivables that we have at the yearend 2001, disappeared by the first half of this year.

Q - Emerson Leite {BIO 4003528 <GO>}

Okay and could you provide some color on the (BNDF) financing -- I think (inaudible) maybe available?

A - Mauricio N Botelho {BIO 13386065 <GO>}

It is available, we are accounted with being there as a strong supporter in our export finance. All the operations that we have to be contracted with (BNDF) are moving on as planned and as contracted. So, we don't see a problem in that respect. And I think that's an important thing goes to mention. It is not directly addressed to (BNDF). But it may also bring other perceptions from the general picture in respect of the (inaudible). The balance of our foreign trade at this moment is over a US \$11b. This means that everything has been working quite well in respect of the -- our foreign trade and with the mechanism that supports this foreign trade. (audio gap)

Q - Emerson Leite {BIO 4003528 <GO>}

Mauricio I apologize. I couldn't hear you perfectly. You said that balance -- the rough balance is over \$11b?

A - Mauricio N Botelho {BIO 13386065 <GO>}

I think, that's (inaudible) is it export versus import. The balance of trade at this moment is above US \$11b. This means, for the country, not for us. But for the country. So, I think that this is also an indication that every mechanism as that supports the foreign trade is working properly.

Q - Emerson Leite {BIO 4003528 <GO>}

Okay. Thank you, very much.

A - Mauricio N Botelho {BIO 13386065 <GO>}

Thank you.

Operator

Thank you. Our next question comes from Rodrigo Pereira of Bank of Pactual.

Q - Rodrigo Pereira {BIO 3824713 <GO>}

Hi. Good morning, everyone. I have two questions here. The first one regarding your Fourth Quarter deliveries. You are planning 45 deliveries during that specific quarter. I would like to know how many of those would be actually produced in the quarter and how many of those would be carried over from the Third Quarter given the delays in the deliveries of the Legacy in the Third Quarter? And, the second question is regarding the financial result, I would like you to kind of explain your financial results -- especially when compared to the Second Quarter when there was a significant FX loss. In this quarter that FX loss was significantly lower. So, I would like you to basically put some color on that. Thank you.

A - Mauricio N Botelho {BIO 13386065 <GO>}

Rodrigo, good to hear from you. Well, our deliveries in the Third Quarter, 45 aircrafts and some of them are coming from the best and the majority would build up and finalized in this year. You know that the Legacy is one of the projects that have been primarily certified in the last quarter and today they are being finalized and the lot of them have started the manufacturing process in the last quarter. And so, we will benefit from that as well. In respect of the second question, I ask Antonio to respond.

A - Antonio L Pizarro Manso

We're having more or less 20% of the total in the inventory through (inaudible) finish.

Q - Rodrigo Pereira {BIO 3824713 <GO>}

That will have (inaudible).

A - Antonio L Pizarro Manso

20% of the deliveries expected for this Fourth Quarter were already ready at the end of the third. Can you repeat the questions please on the financial side please?

Q - Rodrigo Pereira {BIO 3824713 <GO>}

Yes. The question on the financial result was basically explain the difference in the FX loss, the Foreign Exchange loss that was recorded during the quarter, especially when compared to the Second Quarter because looking at the US GAAP numbers, I see a loss

of 58 million in the Second Quarter and a loss of only 19 million in the Third Quarter. How do you explain that given that most of your cash flows in Reais and thus the purchasing power in US dollars in terms of these cash was lowest or you probably had a loss from that cash? And also you had other items that had to be readjusted for the higher exchange rate. That was my question.

A - Antonio L Pizarro Manso

Well, the thing is what you have to consider is that out of the cash balance that we had in September 30th, the \$760m, 32% was in US dollars and 68% in Reais. We had swapped. We increased the heading transaction during the Third Quarter; we increased from 27% to 54% of the dollar denominated debt that we translated into Reais. So the actual match Reais exposure decreased a lot during this Third Quarter decreased to only 30% of the cash and cash equivalence we had. On top of that we also had trade accounts receivable that were in dollars that also benefited there, that net financial transaction loss upsetting that â€¦

Q - Rodrigo Pereira {BIO 3824713 <GO>}

Okayâ€¦

A - Antonio L Pizarro Manso

Offsetting that.

Q - Rodrigo Pereira {BIO 3824713 <GO>}

Okay, thank you.

A - Antonio L Pizarro Manso

Sure.

Operator

Thank you. Our next question comes from Gordon Lee of Goldman Sachs.

Q - Gordon Lee {BIO 1551117 <GO>}

Hi. Good morning, gentlemen. Just a couple of questions; one on defense and then the other on -- the balance sheet. On defense if you look at the results to the first nine months of the year. Revenues there have been a little weaker than you thought initially. Could you give us a sense of what to expect for the rest of this year and into 2003? And just a second question is on the creation of these two subsidiaries that will be used to manage the risk of the residual value guarantees in the repurchase agreements and so on. Should we take that as an indication that you will be increasingly using such features in your agreement with your clients as a way of supporting them to obtain financing?

A - Mauricio N Botelho {BIO 13386065 <GO>}

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(inaudible) to have your regards. Well in respect of the defense market in fact (inaudible) it is developed and below our expectation in this year. Military contracts they are terribly constrained by budgets and there is something that brings difference in our perception. However, if you take our track record, you will see that whatever we target at we will accomplish at the very end. So, what I see is that this year that it will be lower revenue from these markets, which will be recovered in front of us. For instance the FX program [ph], we are fighting for this problem for months and months and months and at several times, we see well there is an expectation to be decided just soon. And I still -- so I am saying that, there is an expectation to have this contract decided before yearend. But there is always postponements in all of those actions. Then unfortunately they are not dependent on our will. They come from government rule, which is a lot conditioned to their budgetary constraints. In respect of our new subsidiaries, what we really meant was to give a clear and formal approach to this problems, which are normal problems in the industry. So if you go through -- if you look at our financial statement ever, we have always comments and notes dealing with this issue, because they are practice of the industry. What we decide to do however is that it should be necessary to be more clearer in that respect at the same time to provide a sort over fiscal planning in respect of all of those exposures in the expense. So I think that in doing that we are rationalizing our operations at the same time that we give clearness in respect of this issue, which is always common and permanent in the industry.

Q - Gordon Lee {BIO 1551117 <GO>}

Perfect. Thank you, very much.

A - Mauricio N Botelho {BIO 13386065 <GO>}

Welcome.

Operator

And your next question comes from line of Ron Epstien (ph.), Merrill Lynch

Q - Ron Epstien

Good morning, everyone. Just a couple of questions. I will start with the easiest one first. The tax rate this quarter was 61%, which seemed to awfully high. Can you offer any color on why that was the case? And then the other questions are, the six aircrafts that you are pending the completion of their financing arrangements, when do you expect that to happen and if you want to hang around on the balance sheet for the next six months to a year or is it just a one quarter kind of a thing? And then if you could give us some color on the residual value guarantees, how big is that liability? How many airplanes are out there? So let's start with those.

A - Mauricio N Botelho {BIO 13386065 <GO>}

Thank you, -- income tax. I have the same -- the same evaluate that you have. It's too high. Antonio explain please, why it is 61%?

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A - Antonio L Pizarro Manso

How Gustavo explained during the presentation. That is not the actual estimate; there is always (transfers from) the Brazilian GAAP to the US GAAP. And that's an amount except we are not making a relation (inaudible). And the -- if you go through the Brazilian GAAP, that's almost completely different. I believe the 11% in this year in this market is quite good. And this 11% is not being in broader sense, a completely disoriented given our (inaudible) we normally have within our balance sheet. I believe that (actual expense) is out to show you exactly the calculation of the Brazilian GAAP and road to transfer to the US GAAP. And Gustavo will talk about this in detail with both of you.

A - Gustavo Poppe {BIO 15816981 <GO>}

Yes Ron Epstein. Hi.

Q - Ron Epstien

Hi! How are you?

A - Gustavo Poppe {BIO 15816981 <GO>}

I'm fine, thank you. The thing is -- I will just give you two examples, okay, of these differences that affect -- that are in Brazilian GAAP and US GAAP. First of all the investments that we make in R&D. This is an expense in US GAAP. So you see that line in our income statement and that reduces the income before taxes.

Q - Ron Epstien

Okay.

A - Gustavo Poppe {BIO 15816981 <GO>}

In Brazilian GAAP these expenses, they are deferred. So these are not -- this increases actually the base for taxation in Brazil so that the tax that is actually paid in Brazil and accounted for is larger because of the deferral in Brazilian GAAP. When we translate this larger amount into US GAAP, the base is actually lower because we consider that expense in income statement, this is one issue. The second issue, we had a very important devaluation during the Second Quarter and during the Third Quarter. So, we have tax credits in our assets, which partially are in US dollars, around 30% in US dollars. What happens in Brazilian GAAP? We have our income statements in the balance sheet in Reais. So the assets that are in dollars, they grow in Reais and therefore they represent a credit in the income statement. And the opposite happens in US GAAP. The 70% credit we have in Reais, they represent a loss. So we have to increase the amount -- the accounting amount of the income -- the tax provision. Okay so that's -- these are two main distortions that I could highlight to you right now.

Q - Ron Epstien

Okay.

A - Mauricio N Botelho {BIO 13386065 <GO>}

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That exactly is the problem. (audio gap). We needed to construct the component in US (inaudible). With respect to the financial ranking, these are operations that eventually may take 3-4 months. But we don't expect this to be more than that. It is unusual, it is not the practice, it is to (sustain) some operations that are not in force several situations not available at that moment. But it's not something that will be there forever. Residual value guarantee -- sorry you had that question about residual.

Q - Ron Epstein {BIO 1868102 <GO>}

Yes about the residual value guarantees, can you just offer some color on how big a liability this potentially is, meaning how many aircrafts have you guaranteed in all? And what's the age of these aircrafts, how big is this? Just more details on residual value guarantees, that would be great.

A - Mauricio N Botelho {BIO 13386065 <GO>}

I would say that every deal that is not -- its not direct sale from financial institution. We may have that in the residual value guarantees for 15-16 years ahead of that. It is normal practice. I would say it is eventually about 60% of the sales without some sort of guarantee like that -- above that. But the point is that these guarantees, they are given based on actual appraisals of those assets by the time that they will be -- they will be demanded. So, in fact, it is in terms of exposure, it is practically no exposure, because it is based on actual appraisals developed by professional appraisals, which define residual value along the time of the asset. So, this is not really an exposure. And turn out Antonio.

A - Antonio L Pizarro Manso

One point is important. (Let me give you the exact) guarantees at the moment. We use a curve of appraisal. That curve of appraisal maybe changing itself at the moment after September 11. And just gave us (inaudible). But I believe that exposure, I think will arise because the (HD60 Lear), at the end of this 60 Lears definitely come back to the same level we gave the investors moments before. Okay?

Q - Ron Epstein {BIO 1868102 <GO>}

Okay.

A - Mauricio N Botelho {BIO 13386065 <GO>}

Thank you.

Q - Ron Epstein {BIO 1868102 <GO>}

Thank you.

Operator

Again, next question comes from (Rusty Johnson) of (Harding Ludner) [ph] .

Q - Rusty Johnson {BIO 3426780 <GO>}

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I had two questions. One regards to the structure of your balance sheet and as you state in your press release, the US dollar is your functional currency. I am curious why you are moving your debt now more into the Reais structure at this type considering your revenues are almost dollars. You have explained why you keep your cash there because you claim your liabilities but it seems you are drifting away from matching currencies and debt and cash in your balance sheet with your income statement as the dollars is your functional currency. And the second one relates to residual value guarantees, if you could come to that second please?

A - Antonio L Pizarro Manso

On the cash strategy, I think that we also have to consider that a good bunch of our expenses are in Reais. So, I would say 75% -- around 75% of our R&D expenses are in Reais. Oh, we have actually two cash flows here in the Company. One US dollars and the other one in Reais. We don't have to convert the Reais that we have in our cash to pay for supplies. When we have a US dollar expense, we pay them with the cash flow in dollars that are coming into the company with the deliveries of the aircraft. We still have to -- to maintain a part of our cash in Reais because of the expenses and planned investments we have. Today, we've around 30% of net exposure in the cash in Reais. I mean, it's much -- I would say better than what we had in the past and very much inline with what we were saying to the market in the past. We think that's the biggest advantages in Reais and they are all completely in Reais.

A - Mauricio N Botelho {BIO 13386065 <GO>}

Then, investments in our expansion is in Reais. So, we have a very strong demand for Reais.

Q - Rusty Johnson {BIO 3426780 <GO>}

Right. But you are also the largest importer in Brazil too, as you are also State's largest exporter and those are all dollars. So, I understand you do have some cost in dollars. But you also in Reais. You also have a lot of them in US dollars. And I can see perhaps why you have a lot of cash there. Frankly it sounds political to me. But what I am confused about is why you are not moving dollar -- your debt now in to Reais, given that your cash flows are 95% dollar? I just don't see the intelligence in this move right now, I'm missing something - yes I can see your expenses. But now you are moving your financial expenses there too.

A - Antonio L Pizarro Manso

Yes and now what we are doing instead of investing more cash in Reais, translating the cash into dollars, we are translating the debt into Reais, because it has proven more cost effective than in a cash flow basis.

A - Mauricio N Botelho {BIO 13386065 <GO>}

And the other point is whenever receipt is from (inaudible) in exportation [ph] -- we receive in dollars. But all into dollars. But we receive Reais the amount. In this case, we have the cash in hand to.

Q - Rusty Johnson {BIO 3426780 <GO>}

I'm sorry. I did not understand the last point. Can you repeat that?

A - Mauricio N Botelho {BIO 13386065 <GO>}

If you are going to ask when financing Brazil (flotation) is very high in equivalent to a dollar but stays in Reais

Q - Rusty Johnson {BIO 3426780 <GO>}

Right.

A - Antonio L Pizarro Manso

And that's the reason that the keep cash is in Reais, which is (6%) of this flotation.

A - Mauricio N Botelho {BIO 13386065 <GO>}

Of convertibility, the goal is to manage the cash particularly in dollars to pay dollars, equal Reais to pay Reais. That is the motto though we try to make this hedge of utilization.

A - Antonio L Pizarro Manso

Financial hedge.

A - Mauricio N Botelho {BIO 13386065 <GO>}

The most natural as possible.

Q - Rusty Johnson {BIO 3426780 <GO>}

Okay. The second one is regarding to the information on the liabilities on the sales, page 13, which is also on your prospectus. To understand correctly, there's 3 issues here. These are repurchase aircraft liability, there is a trade-in auction liability and there is a residual value guarantee. Is that correct? You have 3 things floating around in terms of potential liabilities that you could be financially accounted for. Is that right?

A - Antonio L Pizarro Manso

Yes. It is correct. With regard -- some operations that's the -- there are exposure on repurchase. There are some operations that we have that have residual value guarantees and there are eventually trade-in's to be considered.

Q - Rusty Johnson {BIO 3426780 <GO>}

So, could you explain little bit on the trade-in. For example, if I am Continental and the XR's were not even approved until late October, I may have the intention of trading in some ERJ 145s for 145 XRs. And basically putting back a whole bunch of, say, 30 aircrafts and swapping them for the XR series. So in theory, I mean, I am not really sure what the implications are here. Are we possibly moving within the existing aircrafts or moving within the order book in terms of swapping current orders for future ones and it's not clear in

terms how big this liability can be because you could get hit on pricing, as well as on put backs of existing aircraft, if I read this correctly?

A - Mauricio N Botelho {BIO 13386065 <GO>}

There is actually no specific answer for a specific question. No. That is -- that is not the case. What happens is that as far as 145 XR were certified they ask us to change all the future deliveries. But they still have some few deliveries on 145 LR to XR. So, average delivery to the next project that will come in from (Express) from now on will be in XR. In some situation, some circumstance, they may have a customer -- a certain customer may have the right to put their gross budget, that is a very limited and a very limited case. This is not something normal to happen. There is a very limited case. In all those occasions, the proper assumptions and exposure is that to protect the company in respect of the value in which the (support) will be (gross exercises). In the way that we have, that value always compatible with market value and the financial consideration of that specific deal in a certain -- in a way that these aircrafts can be remarketed and replaced in the market place in a very soft and easy condition.

There is another thing and we will talk about -- and this was (Fokker) and there is restructuring industry that it is recently promoted. We see that more and more in the future (trade name) will be present in a number of deals. If you consider today what we have in our portfolio of all our own aircraft, this is limited to some few Turboprop and (inaudible). I don't have the actual figure. But it's not more than 5-10 Turboprop. How many?

A - Gustavo Poppe {BIO 15816981 <GO>}

4.2%.

A - Mauricio N Botelho {BIO 13386065 <GO>}

4.2% of (inaudible). Sorry there is misinformation here (audio gap). What we were saying is -- I confirm that we have about 7 Turboprop today in our portfolio. If you could see that some other industries in the market they have (tens) and several (tens) aircraft in their portfolio. They -- not only Turboprops, they have also regional jets, they have corporate jets in their portfolio. That's not -- that's been a previous situation that we have in at Embraer. So, what we have tried to do in this organization, new organization; is to handle things, that we'll have to (inaudible), we expect them to be more and more of reality into future in a professional and clear way.

Q - Rusty Johnson {BIO 3426780 <GO>}

Okay -- and just if I understand correctly, on the residual value guarantees, those don't come into effect until, say what, 2006 at the earliest, is that correct?

A - Mauricio N Botelho {BIO 13386065 <GO>}

Residual value guarantees -- they take place at 10 years (inaudible) over a -- of the operation, 10, 15, 16.

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Q - Rusty Johnson {BIO 3426780 <GO>}

But your first deliveries were on the ERJs was in '96, correct?

A - Mauricio N Botelho {BIO 13386065 <GO>}

'96, yes.

Q - Rusty Johnson {BIO 3426780 <GO>}

Okay. So '06 is the first time that you could be liable, is that correct? Or is that -- doesn't -
- can you prematurely put an aircraft before your tenth year?

A - Antonio L Pizarro Manso

I believe in '96, you don't have any -- over about the (RVGs); only offsetting 97,98.

Q - Rusty Johnson {BIO 3426780 <GO>}

Okay, thank you very much.

A - Mauricio N Botelho {BIO 13386065 <GO>}

Thank you.

Operator

Thank you. Our next question comes from Carmen Slade; Salomon Smith Barney.

Q - Carmen Slade {BIO 1512458 <GO>}

Good morning, it's Carmen and Robert Spingarn from Salomon. I will let Robert Spingarn, go ahead.

Q - Robert Spingarn {BIO 5996882 <GO>}

Few questions. Just a follow up Mauricio on which you were just talking about with regard to the trade-in; can you give us some clarity on the number of next years deliveries that will be done on trade-in for regional jets, if any?

A - Mauricio N Botelho {BIO 13386065 <GO>}

First of all good to hear from you Carmen and Rob, how is it going?

Q - Carmen Slade {BIO 1512458 <GO>}

Great, thank you.

A - Mauricio N Botelho {BIO 13386065 <GO>}

Trade ins next year; zero, no one

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Q - Robert Spingarn {BIO 5996882 <GO>}

Okay, (inaudible)

A - Mauricio N Botelho {BIO 13386065 <GO>}

Deliveries.

Q - Robert Spingarn {BIO 5996882 <GO>}

Along the same line, what percentage of next years firm slots are to American and Continental?

A - Mauricio N Botelho {BIO 13386065 <GO>}

I don't know. You've made some difficult questions. (That is answered). You have any other that we can move on?

Q - Carmen Slade {BIO 1512458 <GO>}

I have a couple of, thanks, Mauricio. You were talking about keeping to your 45 deliveries forecast for the Fourth Quarter; and apparently obviously you've had 30 in the last three quarters each and you're not going to have an increase and you mentioned this is because of the legacy has been delayed. Then did you have an increase therefore in inventory for that aircraft going into this quarter; I know that inventories as a whole came down; but I'm just concluding from what you're saying that perhaps; I mean you should have had an increase in inventories for that aircraft, is that correct?

A - Mauricio N Botelho {BIO 13386065 <GO>}

The point is that we are talking; when we talked about regional jets, today we are -- but we are; already with (free-flowing) six months production cycle. And when you look at corporate jet; the production cycle, because of the interior, which was quite different from what you use in the regional jet, you have 10 months of total production cycle. So the aircraft that we are today delivering that will on the Legacy side be where the ways to be adopted to what has been approved and is certified. So some of them were in the production line for months. So we don't -- that's why I say we are increasing our deliveries in the last quarter, because first the Legacy will be several than will be effective in this last quarter.

Q - Robert Spingarn {BIO 5996882 <GO>}

As of follow up to that question then; are you saying Mauricio that the production rate is constant Third Quarter and Fourth Quarter? It's just timing on the deliveries or are you are actually increasing production rates?

A - Mauricio N Botelho {BIO 13386065 <GO>}

No we are in the region of jets increasing (inaudible) deliveries. But lots of the Legacys are also for getting in their delivery phase in this last quarter.

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Q - Robert Spingarn {BIO 5996882 <GO>}

Okay. So what's the monthly regional jet production rate now versus in the Third Quarter and what is the going forward plan for next year?

A - Mauricio N Botelho {BIO 13386065 <GO>}

(inaudible) numbers on Legacys are (inaudible).

A - Antonio L Pizarro Manso

Based on this.

A - Mauricio N Botelho {BIO 13386065 <GO>}

No, no, no. In this (inaudible). Sorry, sorry (inaudible). That 14 aircrafts we delivered the last quarter. But the Legacy how many? I don't know, I think we delivered not last quarter, the last month October.

Q - Robert Spingarn {BIO 5996882 <GO>}

(14) aircraft.

A - Mauricio N Botelho {BIO 13386065 <GO>}

Two Legacys and 12 regional jets. So the regional jets, they are into -- they are growing as the deliveries as well as the Legacys are.

Q - Robert Spingarn {BIO 5996882 <GO>}

Okay and so your increasing production rates despite the fact that the order levels have come down very substantially from last year to this year.

A - Mauricio N Botelho {BIO 13386065 <GO>}

No the point is that, when September 11, 2001 happened, the events happened, we got together with all our customers and rescheduled the deliveries. So the orders are going down. But you remember that we were prepared on October last -- on August last year we had delivered 18 aircrafts. So what happened is that we are presently today with (inaudible) capacity. We had already reached 18 deliveries in the month of August when our plan was to get to December delivering 20. We came down to 10. Now deliveries we scheduled with our customers are making it to happen in that way.

Q - Robert Spingarn {BIO 5996882 <GO>}

I understand that. But what I am saying is the backlog is smaller now than it used to be.

A - Mauricio N Botelho {BIO 13386065 <GO>}

Yes, yes it is.

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Q - Robert Spingarn {BIO 5996882 <GO>}

As that was in August 1.

A - Mauricio N Botelho {BIO 13386065 <GO>}

Well, that's correct. But still there is more than two years production.

Q - Robert Spingarn {BIO 5996882 <GO>}

Okay and then, were you able to come up with the number of American and Continental Aircraft in next year's firm slots ?

A - Mauricio N Botelho {BIO 13386065 <GO>}

(Antonio will get that to you).

Q - Carmen Slade {BIO 1512458 <GO>}

I am just going to jump in with another question if you don't mind. Mauricio?

A - Mauricio N Botelho {BIO 13386065 <GO>}

Sure.

Q - Carmen Slade {BIO 1512458 <GO>}

Of the repurchase agreements for 500m, can you tell us how much -- you mentioned a range from '03 to '07 on that. Can you tell us how much of that would fall into next year? And I don't know that you can comment on who the customer -- the primary customer is on that?

A - Mauricio N Botelho {BIO 13386065 <GO>}

Just a moment please stand.

A - Antonio L Pizarro Manso

No we don't have any coming on next year that we expect. Okay. 500 million is a total amount of the value of the aircraft.

Q - Robert Spingarn {BIO 5996882 <GO>}

Okay so far we have no information that one would be next year.

A - Mauricio N Botelho {BIO 13386065 <GO>}

There is no expectation that this should happen.

Q - Carmen Slade {BIO 1512458 <GO>}

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Okay, in the main theory it could happen anytime between '03 and '07. But you're not expecting it for next year at this time?

A - Mauricio N Botelho {BIO 13386065 <GO>}

Yes, that's right.

A - Antonio L Pizarro Manso

About the Continental and the American user, almost 6% for the next year

A - Mauricio N Botelho {BIO 13386065 <GO>}

60

A - Antonio L Pizarro Manso

60 in to the next year (inaudible).

Q - Robert Spingarn {BIO 5996882 <GO>}

Okay and then just going back to what Carmen said. So in other words the repurchase agreements that would come up in a year or so, those aren't related to the American aircraft that are being swapped back in order for American to take 70-seaters from Bombardier [ph] ?

A - Antonio L Pizarro Manso

Actually, unfortunately we don't disclose, particularly on particular customers, the contracts. Look at the details on the contract. Okay.

Q - Robert Spingarn {BIO 5996882 <GO>}

Okay thank you.

Operator

Our next question comes from Nick Morton, RBC Capital Market. Mr. Morton, are you with us?

Q - Nick Morton {BIO 1830689 <GO>}

Yes. Good morning. Sorry about that. Given the weak financial state of (inaudible). Has that given you a competitive advantage? And that's my first question. My second question is, what's the pricing situation on aircraft now with ERJ's and for Business Jets?

A - Mauricio N Botelho {BIO 13386065 <GO>}

Sorry sir. I didn't -- we didn't hear quite well your question. Could you repeat them please?

FINAL

Q - Nick Morton {BIO 1830689 <GO>}

My first question is given the weak financial condition of (inaudible), your major competitor. Has that given you a competitive advantage with your customers? And my second question is what is the pricing situation on RJ orders? Are you lowering price? Is there a price battle between you and (inaudible)?

A - Mauricio N Botelho {BIO 13386065 <GO>}

Well, in respect to our competitors, I can say that our life is not a ride in the park. It is tough dispute that is present every time, everywhere. There is nothing in fact a price war, what we have is a strong dispute. As you know aircrafts are disputed not only on price, they consider a lot of things. First, what is the situation of the fleet, is this an expansion or is it a new deal? If it is an expansion there is a natural competitive advantage from the manufacturer, which is already established with that customer. The customer service situation (is specifically) in the roots that they are going to be operated and of course price and finance. What I say is that it's not tougher or easier than it was before. It is, just like we have always lived with.

Q - Nick Morton {BIO 1830689 <GO>}

Okay. And what's happening to the price of regional aircraft?

A - Mauricio N Botelho {BIO 13386065 <GO>}

They are there keeping their value, where they are, they are exactly in the way that it has been done. It is no -- significant change.

Q - Nick Morton {BIO 1830689 <GO>}

Okay.

A - Mauricio N Botelho {BIO 13386065 <GO>}

What we have for instance, just to allow you to understand, is that when we have invested so much in the recent past in productivity and I just mentioned that we already are reducing our jets in the 3.6 months production cycle. This means productivity. This means last working capital. This means that you are eventually being able to produce more at the same cost and this brings forth stability for you and this is what we are really practicing. We are keeping our price; we are not fighting for market share, not at all. We are focused on return in investment and value adding to our shareholders and we are not just disputing, just to have a concept. We are disputing to have a profit and this is how we are all working.

Q - Nick Morton {BIO 1830689 <GO>}

Thank you, very much.

A - Mauricio N Botelho {BIO 13386065 <GO>}

Thank you, sir.

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Operator

Our next question comes Daniel McGoey, Deutsche Bank.

A - Antonio L Pizarro Manso

Operator will have time only for this next question, okay.

Operator

Yes sir.

Q - Daniel Mcgoey

Thanks, I think my questions have in principally been answered. The last one I have for you, I think from the prior quarters collection of accounts receivable, which (the interim) -- financially provided in 2001, I think there was still a remaining amount up to about \$100 million that the company was anticipating to collect this quarter. Can you give us an update as to whether that had been collected or is that now part of the additional six aircrafts that were provided interim, financing the Third Quarter?

A - Mauricio N Botelho {BIO 13386065 <GO>}

Just a minute, sir. Just a moment.

A - Antonio L Pizarro Manso

Okay the thing is, we haven't collected yet. Okay, we expect it to be collected pretty soon. Okay, it's been finalized with the (NDS) and Central Bank. This is not included in the accounts receivable. Okay, this is additional amount of around \$120m.

A - Mauricio N Botelho {BIO 13386065 <GO>}

And, I am sure (inaudible) (get it in) the financials.

Q - Daniel Mcgoey

I am sorry, where is it recorded?

A - Antonio L Pizarro Manso

It's into the (order) accounts receivable.

Q - Daniel Mcgoey

And what are your expectations for collection on that?

A - Mauricio N Botelho {BIO 13386065 <GO>}

That is some matter of weeks.

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Q - Daniel Mcgoey

Okay, thank you.

A - Mauricio N Botelho {BIO 13386065 <GO>}

Thank you, very much. I want to thank you for all -- for your attention and hope to see you soon. Thank you, very much.

A - Antonio L Pizarro Manso

Thank you, very much from my side too.

A - Gustavo Poppe {BIO 15816981 <GO>}

Yes. Thank you. I would like to take the opportunity to invite you all for the third investor meeting that we'll hold next week November 21st and 22nd here in (inaudible). Please call us, if you have not yet received an invitation. Okay, our number 5512-3927-1216. Thank you, very much.

A - Mauricio N Botelho {BIO 13386065 <GO>}

Good bye.

Operator

Thank you, everyone. That concludes today's conference call.

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