

## Q4 2012 Earnings Call

### Company Participants

- Frederico Curado, Empresa Brasileira de Aeronautica S.A.
- Jose Filippo, Empresa Brasileira de Aeronautica S.A.
- Luciano Froes, Empresa Brasileira de Aeronautica S.A.

### Other Participants

- Cai von Rumohr, Analyst
- Darryl Genovesi, Analyst
- Joe Nadol, Analyst
- Myles Walton, Analyst
- Noah Poponak, Analyst
- Peter Skibitski, Analyst
- Ron Epstein, Analyst
- Stephen Trent, Analyst

### Presentation

#### Operator

Good morning, ladies and gentlemen. and welcome to the audio conference call that will review Embraer's Fourth Quarter 2012 results. (Operator Instructions) As a reminder, this conference is being recorded and webcasted at [ri.embraer.com.br](http://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," "continue," "anticipate," "intend," "expect," and similar words are intended to identify forward-looking statements. Embraer undertakes no obligation to update publicly or revise any forward-looking statements because of new information, future events or other factors.

In lights 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. Jose Filippo, Chief Financial Officer and IRO; Ms. Elaine Funo, Director, Tax and Accounting; and Mr. Luciano Froes, Director of Investor Relations.

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

**Frederico Curado** {BIO 2004589 <GO>}

Well. Good morning, everyone, and thank you for joining us in the conference. I'll turn it over to Filippo for the formal presentation, and both of us will be back, along with Luciano, for Q&A at the end. Thank you. Filippo, please?

**Jose Filippo** {BIO 1726218 <GO>}

Okay. Thank you. Fred.

We can start with the highlights of 2012, then go through the numbers, and then, open for questions. So let's start on page three of the presentation, starting on the corporate highlights for the year, and we had had this operational performance very good, that surpassed the 2012 outlook, basically within or a little bit above the guidance that we released earlier.

It was a very positive result, although very close to what we forecast to the guidance. I'm going to go in more details during the presentation.

Also, in terms of people, Embraer was elected for the fourth consecutive year as one of the best companies to work in Brazil, and also, we were elected as the best company in people management. This is an important award for one of the major values of the Company regarding our employees and our employeee.

In terms of innovation, we are -- we were awarded, for the second consecutive year, for the FINEP Innovation Award, basically because of the development the Legacy 500 program, as well as programs associated to Arpia and Visiona.

Regarding accounting and the information release, financial information, we were chosen again as one of the most transparent companies by Anefac, related to the release of information in our balance sheet and results.

Moving to page four, still continuing the corporate highlights, Embraer was part of the Dow Jones Sustainability Index for the third consecutive year. That confirmed our commitment to sustainability and good practice in this area.

FINAL

Bloomberg Transcript

FINAL

We had, also, the opening of two excellence centers in Evora, Portugal.

We started the engineering centers in Belo Horizonte in Brazil and in Melbourne, Florida, and we had our second unit of the Embraer High School in Botucato, following the first one that we have currently in Sao Jose do Campos.

Moving to page five, now starting with the business units, the first one, the Commercial Jets, we had the delivery in 2012 of 106 E-jets, 23 of them in the last quarter, within the guidance of the range of 105 to 110, and that reaching 908 total deliveries since the starting of this project in 2004.

We had 7 new operators in 2012, as well as we had 56 new sales in 2012, for the total of 1,093 aircraft now in the-- within 62 airlines in 42 countries.

On page six, continuing the Commercial Jet performance and highlights for the year, we had the signing with Republic Airways of a contract of 47 E-Jets, with an option of an additional 47. This has an important information yesterday with the confirmation from the court that was part of the need for this order, and also we had -- we made the disclosure of the Aldus Aviation contract of 20 airplanes, with an option of an additional 15. This was already part of our backlog, but not disclosed, and the Republic deal, if confirmed, will be part of the backlog that we release in early April for the First Quarter.

Also, we had the delivery number 900 of the E-Jet with the E-190 for Kenya Airways, and an important milestone in the new -- in the second generation of the E-Jet program, which was the announcement of the engine and avionics suppliers for this project. We -- this was announced in January, and we plan for the year to be announcing the starting of the project as a whole.

Overall, moving to page seven, and with the Executive Jets, the highlights for the year, we had the delivery of 99 executive jets, broken by 77 light jets and 22 large jets. As we expected in the typical seasonality of this business, 53 of them were delivered in the last quarter, and we are within the guidance, but important we had a better mix, with a higher number of large jets.

The Phenom 300 program had also two important milestones, with delivery number 100, and also the first flight of the Phenom 300 manufactured in the US in our Melbourne plant.

We had, also, the delivery of the Legacy 600/650 number 200 in China, and in November, as we announced before, the first flight of the Legacy 500, which currently has already two other continuing with this project, as we expected and we reviewed.

On page eight, the Legacy 450 fabrication was launched, this program.

Also, we had the recognition by important magazines of product support, which is very important for executive jet business, and we had the starting production in our plant of

Bloomberg Transcript

Harbin of the Legacy 600/650, and we expect to have the first delivery in the last quarter of this year, 2013.

Concluding the highlights for Executive Jets, we had the expansion of network service, 12 new facilities in 2012. So we continue the expansion, which is an important strategy that we have for the Executive Jet business.

With that, we conclude the highlights of Executive Jet, and we turn to page nine for talk about the Defense and Security highlights. The growth of 24% in terms of revenues compared to the previous year. We reached the level of \$1 billion of revenue, a little bit above the guidance of \$850 million to \$950 million. And it's an important milestone for this business, as well.

We signed a contract with the Brazilian army for the Sisfron project, first phase. This will be bringing us potential revenue of \$400 million in the next three years, and this project has already started.

Also, we had the joint venture between Embraer and Telebras, Visiona, created to participate the program of the Brazilian geostationary satellite. Already at this point, negotiating the contracts for starting the project.

Regarding the KC-390 program, we are ongoing as scheduled. We still plan the first flight for 2014, and first delivery for 2016.

Over to page 10, continuing the highlights of Defense and Security, we had the delivery of 2 out of 3 aircraft for the Indian government. Also, the delivery of Super Tucanos for Indonesia Air Force, Mauritania, and also for the air force of Angola, and we just announced being selected by the US Air Force for the LAS program, which we're now doing the preparations for starting this operation. We've chosen the site in Jacksonville. We're now in the preparations for starting this program going forward.

And final for Defense highlights, the contracts -- continue the contracts with the Brazilian Air Force aircraft modernization. So we had new signatures of new contracts.

And with that, we conclude the highlights of the year for the business units and corporate, and we start to talk a little about the numbers.

Page 11 we have the deliveries for the year. This was already released before. The confirmation of this information that we had 106 deliveries in Commercial Jets, within our guidance, and 99 Executive Jets, major accounted for the last quarter, as we expected for this business.

On page 12, the backlog we already reported the \$12.5 billion of backlog for the Fourth Quarter, in spite of the stronger deliveries that we had in the last quarter, and here we show a breakdown of these three businesses. So 46% of this backlog is related to

FINAL

Bloomberg Transcript

Commercial Aviation, and we see the Executive Aviation and Defense growing in terms of participation to, respectively, 26% and 28% of the backlog.

In page 13, in net revenues, \$6.2 billion in total for the year, within the range of the guidance that we released. It's a growth of 6.5% compared to the previous year.

In page 14, is the breakdown of these revenues through segment and region. In segments, what we see is the reduction of participation of Commercial Aviation -- this is a continuing trend that we expect to see in 2013 -- and the growth of the Defense and Executive Aviation in the portfolio. We have 61% Commercial Aviation, 21% Executive and 17% Defense, broken out by business.

And when we see the regions, in the right side of this shot, we see a well-balanced growth trend, highlight for the North American market growth, but an important contribution of Europe, Asia, and Brazil in this portfolio of regions.

On page 15, the revenues, broken by quarter. So we see the strong revenue in the last quarter of the year, basically driven by the Executive Aviation seasonality, and we amounted to total of \$6.2 billion and BRL12.2 billion for the full year.

On page 16, SG&A expenses -- we kept the same level of 2011, 12%, despite the startup expenses of the Harbin plant, Evora plant, and Melbourne plant that didn't contribute with sales, and will, going forward, this expectation, plus the engineering centers, as well. So going forward, we expect to see a reduction in these expenses as a percentage of sales.

On page 17, income from operations, a total of \$612 million for the year, this is the highest of the last five years, and we were above the guidance and getting to 9.9% above the 9% to 9.5% that we indicated, but basically because of the positive impact of the dollar effect diluting expenses, as well as the impact, positive impact, of the stimulus that both would account for approximately 1% of this margin.

So also, it's good to highlight the comparison with 2011 that was negatively impacted by the American restructuring recognition.

In page 18, if we take the income -- operating income broken by quarter, we see the strong operating leverage in the high revenues on the Fourth Quarter, and compared to the previous year, which was negatively impacted by the American recognition. We had, then, this \$612 million in the year, which is 9.9% operating margin for the full year.

On page 19, regarding EBITDA, we had the strong EBITDA in 2012, above the guidance for the same reasons that we said before, basically because of the operating income margin and the result we came to \$891 million of EBITDA, with a margin of 14.4% for the full year.

In page 20, when we broke through quarters, we see reflecting here the seasonality of the Fourth Quarter, the higher margin and the higher amounts of EBITDA within the

quarters of the year.

On page 21, then come to the final information on net income, the total of \$348 million in the year. Although the strong results in the operational area, we had a negative impact of the income tax calculation, due to the non-cash items affected by the exchange rate, the real/dollar, in Brazil. But even though we had this total of \$348 million, with a margin of 5.6% in the last quarter -- sorry, in the year.

In page 22, we see this net income broken by quarter, and we see the strong results that we had in the last quarter of this year. The comparison with 2011 is not good because 2011 we had the impact of the American recognition.

On page 23, we have the payout of 26% for 2012. We expect to see this remaining, going forward, and accounting for \$1.92 per ADR.

Next page, page 24, talking about inventories, we had a good reduction in the end of the year, an important reduction. This is reflecting the focus on cash management, especially related to inventory management.

There's also a lot of initiatives associated with the P3E program that has been now reflecting into better results. We expect to see the same trend going forward.

On page 25, regarding free cash flow, we had the strong operating cash generation in 2012, a negative free cash flow of \$81 million in the year, basically because of a lot of investments in R&D and CapEx, and some extraordinary items, especially the payment of American debt to BNDES, but it's important to recall that we had in the end of the year an increase in accounts receivable of -- accounting for \$160 million, which we didn't expect to see. So this was postponed, and actually this occurred in the First Quarter of this year.

So this impacted the position in the end of the year, also the negative here is associated to that, but we had operating cash generation. However, the investments and some CapEx expenditures compensated, and we had the accounting for \$81 million negative here.

In page 26, in terms of the investments, we were below guidance where we had that in the Third Quarter. This was more related to the optimization of the development schedule, and also because of the dollar and the stimulus package impacting positively, especially the payroll taxes. The total of \$539 million compared to the \$650 million that we indicated in the guidance.

Last page, 27, this profile of the debt, we had a good debt position and a positive net cash. Basically what we had in the year was the improvement in terms of the average terms of the debt. We had 5.8 years of average terms of the debt compared to the 4.8 in the previous year, basically the issue of new bond of June of 2012 for the 10-year term.

So we're ready to face the needs of investment with this debt profile, and also the cash position.

With that, we close the information of the results, and we now turn back to Fred for the questions. Thank you.

## Questions And Answers

### Operator

(Operator Instructions) Our first question comes from Joe Nadol of JPMorgan. Please go ahead.

**Q - Joe Nadol** {BIO 3056499 <GO>}

Thanks. Good morning.

**A - Jose Filippo** {BIO 1726218 <GO>}

Good morning.

**Q - Joe Nadol** {BIO 3056499 <GO>}

You guys mentioned that SG&A is going to be coming down as a percentage of sales. Could you speak a little bit more about that? Any more color you can give on maybe how much, and is it percentage of sales from 2012 overall or Q4, or from what basis?

**A - Jose Filippo** {BIO 1726218 <GO>}

No, our expectation is to have a reduction in overall. We had -- this year, there was a lot of startup costs that we had in 2012 that we don't expect to see the same impact going forward, so that expectation we have in terms of the G&A expenses, and also we have the -- in terms of selling expenses associated to the level of our activities that we had in that year.

What we expect is basically because of the -- not having the impact of some startup costs that we had in 2012. That's the expectation that we have for the reduction, going forward.

**Q - Joe Nadol** {BIO 3056499 <GO>}

Can you quantify any of that specifically?

**A - Jose Filippo** {BIO 1726218 <GO>}

We're talking about 10% to 11% that we expect to see in the future.

**Q - Joe Nadol** {BIO 3056499 <GO>}

I'm sorry, so down -- okay, that's the general level.

**A - Jose Filippo** {BIO 1726218 <GO>}

From 12% to 10% to 11%.

**Q - Joe Nadol** {BIO 3056499 <GO>}

Perfect. Okay. That's great. Then, Fred, can you give us an update on what you're seeing in the market for E-Jets these days? And any update you can give us? Obviously, we talk all the time about the US campaigns, but any more color you can give on what might be imminent or how you're thinking about it.

**A - Frederico Curado** {BIO 2004589 <GO>}

Yes, Joe, sure. Yesterday, we had the confirmation from the court on the Republic deal. We still are within a one-week stay period. So we have to wait another week to have, let's say, final, undeniable confirmation of that deal. It looks like very, very likely to happen. So that's an important one.

There is a couple of other campaigns going on, large ones, in the United States which may mature relatively soon, in, let's say, months, within the next few months.

Outside the United States, some activity in Latin America, some option activity, that we are dealing with. Importantly, in Brazil in particular, there is under discussion right now a stimulus package for general -- not general, sorry, for regional aviation in Brazil. So the government has opened public consultations with the airlines.

And the idea is to recover the capital leverage of the Brazilian regional aviation network, which just to give you a glimpse of what it was and what it is now, 25 years ago, we had like 250 to 300 airports in service in Brazil. Now it's down to 150. So we had a concentration rather than a decentralization of traffic. And the government wants to stimulate that.

The same -- a similar thing is happening in China. So structurally, that's potentially good news for people producing regional aircraft, including ourselves, but it's just one thing which is going on right now.

Asia remains strong, although much of the strength is still on the, let's say, larger aircraft, larger, narrow-body aircraft. So we hope that with some, call it maturation or saturation, if you will, of those larger aircraft we will resume, let's say, a better balance throughout the fleet, which are an increasing number of regional jets, which today it's -- it's a little bit on the shadow, the shade, of those large orders for the heavy metal.

So overall, we have this, let's say optimistic view on the US and in a certain way balancing out the reduction activity elsewhere. But that's -- I mean, that's good, because in the past, we had for the last several years a lot of activity outside the United States and almost no activity in the United States. It's about time that there is a resumption of that activity.

So mid-to-long term I remember very optimistic about our prospects.



FINAL

**Q - Joe Nadol** {BIO 3056499 <GO>}

Okay, very good. Then just one more, finally, for you. On the business jet side of things, any change or you're still seeing a tough market? Then specifically, on the Legacy 500, what's the latest on timing and how the development process is going?

**A - Jose Filippo** {BIO 1726218 <GO>}

Yes, no significant change in the market. We continue our history of gradually gaining market share in a -- let's say in a tough market. So no big change there.

The Legacy 500 we had now -- we have now two prototypes in flight. I'm not sure about the third. Yes. The third will fly, just confirming the third will fly soon. The campaign is going, actually, better than we expected. The airplane is shown to be more mature than our previous development.

So we are still -- will have all certainty that by the first half of next year we'll be entering into service, sometime in the first half of next year. So looking good, and now, of course, we are kind of resuming the sales effort on that particular model, as well as the 450, as well, which will come one year later.

So the program is looking good. The airplane is looking good. And we are now starting to ramp up our efforts in the sales for that particular model.

**Q - Joe Nadol** {BIO 3056499 <GO>}

Okay. Good to hear. Thanks.

**A - Jose Filippo** {BIO 1726218 <GO>}

Thank you.

**Operator**

Our next question comes from Noah Poponak of Goldman Sachs. Please go ahead.

**Q - Noah Poponak** {BIO 16071528 <GO>}

Hi. Good morning, everybody.

**A - Frederico Curado** {BIO 2004589 <GO>}

Hello, Noah.

**Q - Noah Poponak** {BIO 16071528 <GO>}

Fred, it might be helpful, actual, to just give us the rundown of what is actually left in the US that you're still campaigning in terms of E-Jets. And I know it's -- you don't want to give too much detail because of the competitive nature, but any detail you'd provide on each

Bloomberg Transcript

one, in terms of where you see yourselves stacking up versus the competition, given anything specific about that customer?

**A - Frederico Curado** {BIO 2004589 <GO>}

I don't know. That's a tough one. That's a tough one. I mean, not many players out there, as you know, with the consolidation. We have a reduced number of players. So I don't know what else I can tell you, other than there are discussions, ongoing discussion, and I mean, we are confident. We are confident that we're going to take a significant share of those opportunities, which, again, along this year and the next several months, we will -- we expect to have confirmation.

But I'm afraid I cannot talk about names or quantities or anything like that without really breaching the confidentiality agreements that we have.

**Q - Noah Poponak** {BIO 16071528 <GO>}

Have you guys put together an estimate of the total number of aircraft you think those US campaigns add up to, even if it's a relatively wide range?

**A - Frederico Curado** {BIO 2004589 <GO>}

Yes. We did. Actually, I think we have spoken about that in some previous instances. I think Paulo mentioned something between 400 and 600 aircraft, total, over the next several years. So I think that number is probably still a good estimate, good outlook.

And let's keep in mind, there is a large 50-seater fleet in service, which will eventually be substituted by larger, newer aircraft. So the numbers sound about right. That's what I think -- that's our outlook.

**Q - Noah Poponak** {BIO 16071528 <GO>}

Okay. Then on the Brazil-specific thing you were just talking about, could you just elaborate on that a little bit more? I mean, is that -- how new is that? How long has that been going on? Is it something that could drive activity sooner than later? Or is it really a much longer-term thing that would take a fairly long time to play out?

**A - Frederico Curado** {BIO 2004589 <GO>}

It is relative new. I mean, just before Christmas, right before Christmas, the government announced their desire to incentivize regional aviation, in other words, flights, commercial flights, into cities which have no service today and to foster economical development.

This, in January-February, has been open for public debate, and -- but the idea is to -- a combination of tax reductions in those airports, investment in infrastructure, for, let's say, call it regional airports, and maybe even some sort of support to the airlines in some sort and form for them to fly -- to incentivize them to fly to cities which have no service today.

FINAL

Bloomberg Transcript

FINAL

So I think the instruments will be put in place relatively in the short term. I think -- I don't know, but certainly not a matter of years, a matter of months, probably. How long that then will create a chain reaction, positive chain reaction to drive traffic and then drive demand for new aircraft, obviously, there is a delay there. But the implementation of the plan it's -- really, the way the government is playing this thing, like several other instruments they are trying to boost the Brazilian economy, I think it's going to be implemented relatively soon.

**Q - Noah Poponak** {BIO 16071528 <GO>}

Right. That's real interesting. Okay. Thanks a lot.

**A - Frederico Curado** {BIO 2004589 <GO>}

Thank you.

## Operator

Our next question comes from Peter Skibitski of Drexel Hamilton. Please go ahead.

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

Good morning, guys, nice quarter.

**A - Frederico Curado** {BIO 2004589 <GO>}

Thank you. Good morning.

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

Just a couple of questions on the quarter itself. I might have missed this. I couldn't see the slides, but could you tell us why research expenses came in so far below guidance? Then maybe also the same question regarding development spending?

**A - Jose Filippo** {BIO 1726218 <GO>}

Okay, Peter. The spending was -- basically we had optimization of the schedule, of the investments, but also the impact of the exchange rate affected us positively, the expenses. Basically, we had a dilution of the expenses in local currency, as well as some stimulus package impact in the payroll taxes. So this reduced part of the expenses expected and explains the reduction in terms of the guidance.

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

I understand. I understand. Are you still expecting \$100 million in research expense for next year?

**A - Jose Filippo** {BIO 1726218 <GO>}

Yes. That's the guidance that we released recently.

Bloomberg Transcript

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

Got it.

**A - Frederico Curado** {BIO 2004589 <GO>}

\$100 million for research and about \$300 million for development.

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

Understood. Understood. And the, I guess, Jose Filippo, typically your labor wage growth is fairly high due to, I think, inflation. Could you tell us how much you're expecting labor wage growth to be in 2013?

**A - Jose Filippo** {BIO 1726218 <GO>}

Yes. What we had before, we've been experiencing because of the -- specifically the situation of the market, higher adjustments in salaries because of some negotiations. We -- going forward we don't expect to see the same level. Recently we announced about 6%, which is basically inflation, for the adjustment for this year. So we don't expect to see it like adjustments above inflation in terms of the salaries. That's why we see for the future.

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

Okay.

**A - Jose Filippo** {BIO 1726218 <GO>}

And -- but the positive side is that we still have, now, the full impact of the stimulus package, especially the payroll burden, that was -- we started to have this impact in the Third Quarter of last year. For 2013, we expect to see it in the full year.

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

Understood. Okay. Then, I guess, well, maybe I'll ask you one more question on margin. It -- if we look back at 2012, you had a couple of excellent margin quarters, a couple lower quarters. It kind of corresponded with your volume level, and I'm wondering, maybe, Frederico, as you look out, not necessarily at 2013, but maybe '14, '15, when your volume levels, potentially, could be much higher, is there sort of a target, an overall target operating margin rate that you have kind of tucked away that you think you can hit?

**A - Frederico Curado** {BIO 2004589 <GO>}

Well we certainly do. I mean, internally, we, of course, we are cautious about releasing guidance beyond our the actual year, but this Company is very sensitive to volume, as you just outlined. I Mean, with higher volumes we will tend to have margins up for sure. So thinking about a double-digit EBIT margin is not something which is out of the question.

On the negative side, in the next few years we have also to -- always to remind that, although we may have rising values, the mix of products may not be that favorable in the

sense that we're going to have in the E-Jets family a lot of demand coming from the United States regionals. And this means two things -- one, it's a smaller aircraft, so it's a lower tag price aircraft, the 175, not a 190 or 195, and clearly, with large volumes, we tend to have pressure on margins, as well.

So balancing out, I -- it's -- I think it would be premature today to be very bullish on a step-up, as far as margins, but the effect of volume in our operation is very significant. We are -- the higher volume this Company -- we will be, at least, actually, when we have it, much more efficient than we are. So those are the major forces, one on the one side, positively, and some pressure on the top line, on the other side, due to mix and large orders and relatively lower margins to those large quantities.

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

I appreciate the color. That's great. If I could just sneak in one last question, could you remind us what your services revenue is expected to be in 2013, across the Company?

**A - Frederico Curado** {BIO 2004589 <GO>}

If we -- yes, so we are -- as you know, we are trying more and more to consider that part of each of the businesses, but if we slice it through the three main areas, the three business areas, it's about how much, Luciano?

**A - Luciano Froes** {BIO 17907241 <GO>}

\$800 million.

**A - Frederico Curado** {BIO 2004589 <GO>}

About \$800 million, \$850 million.

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

Wonderful. Thanks very much, guys.

**A - Frederico Curado** {BIO 2004589 <GO>}

Thank you.

**Operator**

Our next question comes from Myles Walton of Deutsche Bank. Please go ahead.

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

Thanks. Good morning, guys.

**A - Frederico Curado** {BIO 2004589 <GO>}

Good morning, Myles.

FINAL

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

I was hoping to go back to the margin discussion for just a second. If I took 2012's 9.9%, correct it for Chautauqua, I think it's about 10.5%, 10.6% on a clean basis in 2012. And Filippo, I think you said year on year you'll get 100 basis points of help from SG&A. I would calculate that the stimulus would add, probably, another 100 to 150 basis points. So and yet the guidance is 9% to 9.5%.

And I know, Fred, you mentioned the pricing and the mix dynamic, but are we really talking about pricing and mix being a 250 to 300 basis point headwind to EBIT margins in '13, or is it just really conservative?

**A - Frederico Curado** {BIO 2004589 <GO>}

It may happen. It may happen, Myles. I think at this stage, it would be premature to take a more optimistic view. I mean, the 175, it's a smaller aircraft, so we will have a reduction in revenue, and on top of that, and on top of that, we're going to have, also, pressures on margins, specific margins.

So it's -- it will depend a lot on how we perform in the next few campaigns, of course, but don't -- let us also look at the other businesses. Because more and more commercial jets are not the only pieces of Embraer. Next year it's going to be something around -- between 50% and 55%. So we have to look at the other two, as well.

So the executive jets, it's still a very hard market out there. So we are gaining market share, yes. We are gaining some -- having some advantages in volume, yes, but there is a pricing pressure there, for sure, at least on the segments that we are in, from the Legacy 650 downwards, it's a tough market.

So we're not seeing the handsome margins that we would like to see, but, of course, we are balancing out margins versus market share versus volume and trying to optimize these contradictory forces.

In Defense, as well, we're not -- in 2013, we're not projecting a very high margin due to a combination of things. If you take the projects that we have in development and so forth, so the typical higher margins in defense, as we increase our volume, as we diversify our base, we also have some margin there.

So we feel comfortable within the guidance that we have given, and, obviously, if we feel, let's say by mid-year, that this becomes conservative, we will revise it, as we did last year. But at this stage, I would not move the needle where we are.

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

Okay. Okay. Then the other question I had was, one on cashflow for '13, what is the targeted free cashflow, at this point, given kind of the push out of the receivables you talked about, as well as whatever cash outflow there is from the American and/or Chautauqua settlements?

Bloomberg Transcript

**A - Frederico Curado** {BIO 2004589 <GO>}

Yes. We expect a positive, probably a double-digit positive cashflow -- I mean, yes, free cashflow, actually, Filippo?

**A - Jose Filippo** {BIO 1726218 <GO>}

Yes, I think that maybe we should -- a good opportunity to clarify the 2012 calculation. We have a good operating cash generation, but there's a lot of investments in projects that were not generating cash.

And also, with that, we had this payment of -- that was concentrated to American, the \$51 million. We expected to have this diluted within the terms of the contract with BNDES. That was the agreement. But unfortunately, as the court didn't approve fully, we had to meet the schedule as originally to us, a concentration in September and March. So that affected last year.

We expected after the Third Quarter of 2012 to have a positive in the end, a small positive -- some positive cash. We missed that because of some accounts receivable that we didn't expect that was just, like, slipped to 2013.

And moving forward, what we expect is to really, like, control the expenses, especially in the CapEx investments, but also expenses, and focus on cash generation through the working capital, inventories and accounts payable.

So we are really working on the target to have a positive for this year, 2013, which we almost -- I think we had a good position last year, if you assume all the events that we faced, but for 2013, I think we could -- we will be able to perform -- we don't give a guidance specific for that, but we're working on a positive generation for this year.

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

Okay. All right. Thanks, guys.

**A - Jose Filippo** {BIO 1726218 <GO>}

Thank you.

**Operator**

Our next question comes from Cai von Rumohr of Cowen and Company. Please go ahead

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

Yes. Thank you very much and good result. So you mentioned the decline in SG&A and you kind of mentioned some specifics for G&A. Selling expense was up 60 basis points last year. How much of the decline from 12.3% to 10% or 11%, whichever it is, should come from selling expense, and why?

**A - Frederico Curado** {BIO 2004589 <GO>}

Just a second, Cai, we are --

**A - Jose Filippo** {BIO 1726218 <GO>}

We get the detail here.

**A - Frederico Curado** {BIO 2004589 <GO>}

Well Cai, while they look for the numbers, we're certainly targeting the fixed costs. On the A side, obviously, it's fixed costs, G&A. On the S side, part is proportional to sales, and part is fixed. So that part is being targeted as -- in our efficiency -- in our excellence program, along with G&A. On the variable part, just a second.

**A - Luciano Froes** {BIO 17907241 <GO>}

So yes, hi, Cai. This is Luciano. Just elaborating a little bit on the selling expenses, so in 2012 we had a few activities related to some of the aircraft that we took in on trade as it relates, not specifically with the trade, but the American Airlines restructuring process, and so, of course, the maintenance related to those activities, and expenses for remarketing them categorized under our selling expenses.

So we expect that that should not necessarily reoccur in 2013. So that will also contribute to that reduction coming in at about 10% to 11% of total SG&A for 2013 revenue.

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

So the bigger decline is really going to come in selling, percentage-wise?

**A - Jose Filippo** {BIO 1726218 <GO>}

Yes. There is commission, too. The selling going to have this reduction because of the expenses that Luciano just mentioned, and the G&A for the maintenance of certain level diluting would benefit the full impact of the stimulus package in this year in terms of the cost of the payroll.

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

Great. And you mentioned the variable and fixed part of selling. Approximately, what part of selling would you say is fixed? Because, obviously, the variable, sometimes if that's higher, that's for a good reason.

**A - Frederico Curado** {BIO 2004589 <GO>}

Yes. I think around, what, 80% and 20% variable. Is that right?

**A - Luciano Froes** {BIO 17907241 <GO>}

Yes.

FINAL

Bloomberg Transcript



FINAL

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

Okay. That's terrific. Then could you quantify, roughly, how big was the tax stimulus benefit in 2012 and how much you expect in your guidance for 2013?

**A - Luciano Froes** {BIO 17907241 <GO>}

Okay, so, yes, Cai, for 2012, the effects of the stimulus package was roughly 1% of total revenues, right? So for 2013, we expect the same figure that we've been saying at around \$100 million.

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

Got it. Okay, excellent. Excellent. Okay. Great. Thanks so much.

**Operator**

Our next question comes from Ron Epstein of Bank of America Merrill Lynch. Your line is open. Please go ahead.

**Q - Ron Epstein** {BIO 1868102 <GO>}

Yes, hey. Good morning.

**A - Frederico Curado** {BIO 2004589 <GO>}

Good morning, Ron.

**Q - Ron Epstein** {BIO 1868102 <GO>}

Maybe two questions no one's talked about yet. How is the development of the KC-390 going? Where are we on that program and how's it going? So I'll start with that.

**A - Frederico Curado** {BIO 2004589 <GO>}

Okay. Going well. It was, actually, in that program that we had this unexpected accounts receivable which was not paid last year and is going -- actually, it's being paid as we speak, so, it's going to be in this quarter. But the physical part of it, the program is moving well. We have a big CDR coming in weeks. I mean, the engine is looking great.

The changes, perhaps, has really increased the traction on the engine side, after they took over the roles on the IAE. So technically, we are simulating and making everything which is new in the program, we are way in advance, trying to have a mature system by test and by rigging and by some other things.

So although we have a big technical challenge in the program, so far, so good. And first flight scheduled for end of next year, still. That's still the plan and that's still the schedule. And I think if we have our cashflow coming as it has come in the last three years, relatively on time, I see no reason why we should not be on time.

So very optimistic about the program. I think this is it. All the main contractors are already selected and CDR going all right now, and shall be finished before midyear.

**Q - Ron Epstein** {BIO 1868102 <GO>}

Okay. Great. Then -- and how are the programs going for the next generation E-Jet? I mean, where does that stand? And when -- I mean, what kind of time calendar should we expect, I guess, an official launch of, potentially, a stretched 195?

**A - Frederico Curado** {BIO 2004589 <GO>}

We are -- Ron, my major concern was to make sure we had a kick-ass engine, and we nailed that down late last year. So the airplane will be a blockbuster. I mean, I said the airplane, the family of airplanes, the new airplanes, will be blockbusters. We are very convinced of that.

And now avionics already selected. Significant step up in this new Honeywell avionics suite, really nice avionics package. We may change some other suppliers in the next few months, as well. So as you know, we are rebidding most of the systems of the aircraft, if not for -- not only for improvement, but also for cost reduction, because we need to, of course, increase our competitiveness.

So we are still, targeting somewhere by midyear official launch, and, hopefully, working some launch customer activities. Ideally, I would like to launch this aircraft to -- I mean, this new version. It's not a new aircraft. This new version of the aircraft with some launch customers.

So but I'll say midyear is a good bet for, let's say, the formalization of the launch of the G2, and between now and then, we will have, on one side, the selection of the remaining major systems of the airplane, and, on the other side, an increasing level of activity on the sales side.

**Q - Ron Epstein** {BIO 1868102 <GO>}

Great, perfect. Thanks.

**A - Frederico Curado** {BIO 2004589 <GO>}

And needless to say, 2018 is still our entry into service date.

**Q - Ron Epstein** {BIO 1868102 <GO>}

Actually, is there any chance it could happen earlier, or no?

**A - Frederico Curado** {BIO 2004589 <GO>}

I think it's hard. Because -- I think it's unlikely, because, we're talking about two new wings, and major difference in installation of the airplanes, probably changes in the landing gear, as well, less co-generation. So it's -- I -- at this stage, I would not count on anything earlier

FINAL

Bloomberg Transcript

than 2018. It's a very just schedule. It's not -- there's not too much slack in there. It's a major -- it's not a re-engine-ing, it's a major revamp of the airplane.

**Q - Ron Epstein** {BIO 1868102 <GO>}

Okay. Great. Thank you very much.

**A - Frederico Curado** {BIO 2004589 <GO>}

Thank you.

## Operator

Our next question comes from Stephen Trent of Citi. Please go ahead.

**Q - Stephen Trent** {BIO 5581382 <GO>}

Hi. Good morning, everybody, and thanks for taking my questions.

**A - Frederico Curado** {BIO 2004589 <GO>}

Thank you, Steve.

**Q - Stephen Trent** {BIO 5581382 <GO>}

Hi. Good morning. Two questions, if I may, for you, Fred.

The first is, when I think about -- getting back to the selling expenses, when I think about the potential E-Jet opportunity in the US market, do you see any possibility of an uptick in selling expense versus some of the lower selling expense that you may have received as in some cases some of the aircraft sales to Venezuela and China were government to government activity, as opposed to you guys putting in a bunch of marketing and advertising dollars? And how are you thinking about that?

**A - Frederico Curado** {BIO 2004589 <GO>}

No, Steve, I -- actually, it's probably the other way around. We're talking about very, let's say, knowledgeable customers, a very small number of very well structured customers. They know what they want. Advertising is almost non-existing there for that purpose.

So it's really down to pricing pressure and then actually sales expenses for those. So it's a few airlines, large orders. They know us for -- we've been in the market forever. So it's a relatively straightforward campaign. So no major -- it's less than, for example, breaking ground on Eastern Europe, for example, or Middle East or Africa. We would have to invest a lot in marketing and pre-sales campaigns before selling 2s and 5s and 10s.

So I feel kind of the other way around. But margins, as I already spoke before, margins is a challenge.

FINAL

**Q - Stephen Trent** {BIO 5581382 <GO>}

Great color. Great color. And just one more question, also related to the US market. What do you think about not only the potential E-Jet campaigns here, as well as looking at the Defense side? How are you thinking about the evolution of the budget debate in Washington with respect to Defense spending, with respect to some spending on aviation possibly putting pressure on the FAA's budget here. And do you see -- are you thinking about any potential impact there on the Defense or Commercial business lines?

**A - Frederico Curado** {BIO 2004589 <GO>}

Well we -- as you probably know, we just conquered this LAS program and the Super Tucano, along with Sierra Nevada. And we understand this contract is well shielded from any sequestration or any budget reduction, because this is an Afghanistan, let's say, exit plan, part of that integral plan.

So we believe this program is well protected, budget-wise, and, obviously, the main strategic -- the main value of this program for us is more of the strategic side, even more than the actual value of the contract.

So our ability to expand our activities for DoD, it's -- we never had any opportunity. Now we believe we do, by having this door open on the LAS.

Our programs, Steve, are so small, are so, let's say, immaterial to the DoD budget, that we kind of see ourselves as, if there is a need for those niche applications such as the Super Tucano counter-insurgency aircraft, we are fundamentally the only show in town for that, we have some new businesses which are, again, immaterial for the huge DoD budget.

As far as the FAA and some implications for Commercial Aviation, I have a little bit of a concern about the business jet side, more than Commercial Aviation, because of the some of the speeches that we have heard from the President of the United States, talking about taxes and then stuff about the business jets, which had a strong reaction from Gama, as you know, and BAA, as well.

So that may be. We don't know. We don't have much more information than what is in the press. But I'm more concerned on that side than on the Commercial side, which I think is a public service and it would not be very wise to change a game which is finally producing positive results. I mean, the US airline system is definitely on the right track, in our opinion.

**Q - Stephen Trent** {BIO 5581382 <GO>}

Okay. (Spoken in Portuguese).

**A - Frederico Curado** {BIO 2004589 <GO>}

(Spoken in Portuguese).

Bloomberg Transcript

**Q - Stephen Trent** {BIO 5581382 <GO>}

(Spoken in Portuguese).

## Operator

Our next question comes from Darryl Genovesi of UBS. Please go ahead.

**Q - Darryl Genovesi** {BIO 20862546 <GO>}

Good morning.

**A - Frederico Curado** {BIO 2004589 <GO>}

Hello.

**Q - Darryl Genovesi** {BIO 20862546 <GO>}

So just looking at your commercial services business, in 2012 it looks like you grew about 4%, and I'm just comparing that to the flight hours on Embraer aircraft over the past year, which is more like 9% or so. So just wondering, is there some reason why the services growth should kind of lag what's going on with growth in flying hours? Yes, I guess any color there would be appreciated.

**A - Frederico Curado** {BIO 2004589 <GO>}

Thank you. Luciano, (inaudible)?

**A - Luciano Froes** {BIO 17907241 <GO>}

Yes. Darryl, so as we -- as Fred mentioned, we expect roughly, again, even though we're trying to really focus more on a business unit consolidated figure, the services revenue overall should be around \$800 million to \$850 million, so that is still representing growth from a base of around \$740 million that we had this year, in 2012.

I mean, so we continue to grow at a nice rate.

**Q - Darryl Genovesi** {BIO 20862546 <GO>}

Well I mean -- No. I mean, I was just looking at 2012, right? I was just looking at the commercial aviation services number that you reported, the 424 versus the 409 in 2011. So that was just the comparison I was doing.

**A - Luciano Froes** {BIO 17907241 <GO>}

Yes, I mean, there it's specifically related to the overall services that we see in line with the fleet utilization vis-a-vis, of course, some of the maintenance that may be performed in house by a lot of these operators that have their operations or are spare parts pool programs and so forth. So that's the general trend there.

FINAL

**A - Frederico Curado** {BIO 2004589 <GO>}

I would just add that in the last couple of months we signed two -- I think it was two -- important deals in that regard, Darryl, one with Azul and one with Republic, which extend our services out to our extended portfolio of service, the pool program for spare parts and the term, as well, like 10 years out or something like that. I don't remember exactly by heart.

So we should see an increasing participation of that. I would not know how to quantify that to you, but I would imagine to grow at least the growth rate of the business unit as a whole, if not more.

**Q - Darryl Genovesi** {BIO 20862546 <GO>}

Okay. Thank you.

**Operator**

And with no further questions at this time, I'd like to turn the conference back over to Mr. Frederico Curado for any closing remarks.

**A - Frederico Curado** {BIO 2004589 <GO>}

Okay, just thank you very much for the participation and look forward to talking to you. Oh, yes, we do have an announcement. Luciano, please about our Embraer Day?

**A - Luciano Froes** {BIO 17907241 <GO>}

Thank you, Fred. So we wanted to also take the opportunity to update everyone. Given the very recent communication and ongoing dialogue that we've had with the market, considering, of course, the release of the guidance in early February, as well as today's call, and a lot of the richness in the market updates and so forth, we thought it would be best to postpone the Embraer Day that will take -- previously scheduled to take place on the 25th of March, as it would be a little bit redundant in terms of the information that we would be discussing.

So with that said, we will get back to you at a later date in terms of when we will hold that event. However, important to note, for those that would still like to see the facilities, we will be doing that on the 26th. But the vent on the 25th, we will be postponing. So more details on that to follow, but we also want to take the opportunity of the call to give you that update and the rationale behind it. Thank you.

**A - Frederico Curado** {BIO 2004589 <GO>}

Thank you.

**Operator**

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

Bloomberg Transcript

FINAL

*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.*

Bloomberg Transcript