

## Q1 2007 Earnings Call

### Company Participants

- Anna Cecilia Bettencourt, IR
- Antonio Luiz Pizarro Manso, CFO
- Frederico Fleury Curado, President, CEO
- Marcello Rodrigues, Controller

### Other Participants

- Bernardo Carneiro, Analyst
- Byron Callan, Analyst
- Christine Min, Analyst
- Dan Khoshaba, Analyst
- Heidi Wood, Analyst
- Joe Nadol, Analyst
- Mike Schwabe, Analyst
- Robert Pickels, Analyst
- Ron Epstein, Analyst
- Stephen Trent, Analyst
- Unidentified Participant, Private Investor

### Presentation

#### Operator

Good morning, ladies and gentlemen. and welcome to the audio conference call that will review Embraer's First Quarter 2007 Results.

(Operator Instructions)

This conference call includes forward-looking 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, assumptions, including, among other things, general economic, political and business conditions in Brazil and in other markets where the Company is present. The words believes, may, will, estimates, continues, anticipates, intends, expects and similar words are intended to identify forward-looking statements.

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Participants on today's conference call are Mr. Frederico Fleury Curado, President and CEO; Mr. Antonio Luiz Pizarro Manso, Chief Financial Officer; Ms. Anna Cecilia Bettencourt, Head of Investor Relations; and Mr. Marcello Rodrigues, Controller.

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

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

Thank you, Joe. Good morning, all. Thanks for joining our conference call. We'll be discussing the First Quarter results in U.S. GAAP. We released those yesterday simultaneously with the financial statements in Brazilian GAAP.

Well I guess I should start by talking about the difficulties that we faced in this quarter. We delivered 25 jets. We encountered some difficulties, too, with the supply chain of our E-Jets. Those 25 aircraft compare to 27 aircraft in the First Quarter of last year.

. So there are some slides there that you can follow.

So our gross margin was 25.7% in this quarter, lower than what we had last year due to those factors I just mentioned.

On the good news side, our backlog reached a \$15 billion (inaudible). So that's a \$15 billion of firm backlog. We registered this quarter 11 firm orders, 5 for MI Travel and 6 confirmed options for Virgin Blue. We also disclosed that our undisclosed customer already in our backlog as of last year is Alpi Eagles, an Italian carrier, will be taking 195s. On the executive jet business, our Phenom 100 and Phenom 300, they're nearing 400 firm units at date and, therefore, having a very promising perspective.

We are continuing and intensifying the actions towards assuring our guidance of 165 to 170 deliveries this year. Maybe a summary of those actions, I should mention that we have hired about 2,000 employees to date this year. There's still another probably around 1,500 to go in the next few months.

We hope that by the Third Quarter of this year the whole integration of those people will be finished. That includes a third shift in some of our production areas, some of our working centers. That, of course, will be for the mantle for our production, the consolidation of our production ramp-up.

We have also -- we are also in the final stages of duplication of some of our assembly jigs, one which is known, I guess, to everyone is the 190 wing. We did have a little bit of delay

because we had said that by April, the fourth jig would be up and running. It is late a little bit, but everything will be done in this semester.

We also have finalized duplication of some of the fuselage of the one of the E-Jets jig. And in parallel, there is an effort to increase and spread our subcontracting base. Those are parts which are manufactured by subcontractors. So this is also in progress. And some other internal actions in our production facilities.

So in summary, we remain -- in spite of the 25 delivered in the First Quarter of this year, we remain confident that we'll be able to achieve our projected 165 to 170 deliveries in this fiscal year. So having said that, I'll be, of course, available at the end for questions. But I'll ask Anna Cecilia to go on and talk a little bit about the details. Please, Anna?

### **Anna Cecilia Bettencourt**

Thank you, Frederico. Well we delivered 25 aircraft in the First Quarter of 2007 compared to 27 delivered in the same period last year and to 37 in the last quarter of 2006. Approximately 60% of aircraft delivery forecast for 2007, which is 165, 170 aircraft, as mentioned by Frederico. I expect it should be concentrated in the second half of the year.

Due to a better product mix, despite lower number of aircraft delivered in the First Quarter 2007, net revenues increased by 4.3% when compared to the same period of 2006. As already mentioned by Frederico, the gross margin decreased from 28.7% in the First Quarter 2006 to 25.7% a year ago.

The \$12.9 million nonrecurring adjustment accounted in the work in process inventories represented a negative impact of 1.5% in our gross margin. In addition, production overtime work negatively affected our gross margin, representing 2.3% when we compare those periods.

Net revenues for the commercial aviation segment reached \$550 million and accounted for 65.3% of our total net revenue in the First Quarter 2007 compared to \$504 million and 62.4%, for this activity in the same period of 2006.

Net revenues for the executive aviation segment increased 39% from \$86 million in the First Quarter 2006 to \$119 million in the First Quarter 2007. Its participation on the total Company's revenue increased from 10.7% to 14.2% in the same period while revenue of customer service and other segments remained relatively stable with \$136 million between First Quarter 2006 and First Quarter 2007.

On the other hand, defense and government net revenues decreased from \$78 million in the First Quarter 2006 to \$37.5 million in the First Quarter 2007. The decrease is mainly due to two Embraer 170s delivered to TAME, Ecuador's state-owned airline, in the First Quarter 2006.

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As a result of lower gross margin, high operating costs, cash generation measured by EBITDA was \$23 million in the First Quarter 2007 compared to \$62 million in the same period last year. Therefore, net income in the First Quarter 2007 decreased by \$39 million over the same period in 2006, reaching \$26.2 million, which is equivalent to \$0.14 of earnings per diluted ADS.

During the First Quarter, trade accounts receivable and customer financing remained stable at \$276 million and \$554 million, respectively. Our total exposure to sales financing activities in the First Quarter 2007 were \$223 million compared to \$270 million at the end of December 2006.

And inventories during the First Quarter 2007, inventories increased by \$270 million, reaching \$2.3 billion at the end of the quarter. This increase [ph] is due to a number of aircraft in the final assembly stage and high inventories which are necessary for the expected increase deliveries for the ramp-up for the upcoming quarters.

As a result of higher working capital requirements and low operating results, Embraer reached a net cash position of \$217 million in the First Quarter 2007 compared to \$416 million at December 31, 2006. At the end of the quarter, Embraer's cash holdings and temporary cash investments were \$1.4 billion. On the same date, short; and long-term loans, excluding non-recourse debt and recourse debt, reached \$1.2 billion.

Of the total debt, 64% is long term, and 20.9% is effectively denominated in reals at the weighted average interest rate of 7.1% per annum, compared to 9.12% in December 2006. The remaining \$968 million is denominated in other currencies, primarily U.S. dollars, with a weighted average interest rate of Libor +1.69% per annum, which its cost remained more or less the same compared to December 31, 2006.

In addition, our average debt maturity [ph] increased from four years and four months in December 2006 to four years and nine months in March 2007.

Now talking about backlog. We ended the quarter with 53 firm orders in backlog for the ERJ 145 jet family that will be assembled in our joint venture in China. Since the launch of the E-Jet, we have sold 630 aircraft, of which 229 were already delivered. Therefore, the firm order backlog for the E-Jets reached 401 aircraft at the end of the quarter, which includes the order already mentioned by Frederico Curado.

As mentioned by Frederico, our firm backlog reached a record level of \$15 billion and includes orders for our commercial aviation, executive aviation and defense and government segments. As mentioned, actions taken regarding our industrial and operating capabilities were implemented, allowing us to deliver between 165, 170 jets in 2007.

Now we may open the conference call for question and answers. Thank you.

## Questions And Answers

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## Operator

(Operator Instructions)

Our first question is from Joe Nadol at JPMorgan.

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

Good morning.

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

Good morning.

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

My first question is on the gross margin. I'd like to, I guess, just explore what expectations might be for the Second Quarter? You've said in the past that we should expect a sequential improvement through the year. So if we take the 1.5% inventory charge and we add that to your 25.7%, you get 27.2%, which is just a little bit below the Fourth Quarter --

(Technical difficulty)

Hello? Okay.

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

You're back, Joe. We heard you.

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

Yes, okay. So 27.2%, ex the charge. You have these new employees coming in. You're taking some of the employees that you hired in the First Quarter, they're going to be actually producing aircraft in the Second Quarter. But you're hiring new ones. But what's a fair expectation, netting all that in, for gross margin in Q2?

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

Well Joe, we'll stick to our 30% margin by the end of the year. I would not have a specific for the quarter. But we are still targeting, reaching the 30% level by year end, as we have divulged in the past. It's, of course -- and why is that? Why are we growing?

The fundamentals are there's a lot of expenses related to the training of those people. We have basically an average 90 days between actually hiring the personnel for production and having them actually working the aircraft through a training process, which, of course, drags on a little bit on our productivity.

So this is a trend is what we're trying to stick to, and again, it's hard to give you a step-by-step towards reaching that. But Antonio, too, if you wanted to make some comments?

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**A - Antonio Luiz Pizarro Manso** {BIO 1845027 <GO>}

What would be possible to consider is we don't go to receive another kind of a special decrease [ph] as we had in this quarter, the \$12 million or \$13 million. And it's certain that is almost 1.5% more, would be possible to consider? Certainly, this is the minimum would go to aggregated in the next quarter.

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

So what you're saying, we should expect at least 27.2% and hopefully better in Q2?

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

Yes.

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

Okay.

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

Which, if you compare to our last quarter, last year is about the same, same level.

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

Right. Okay --

**A - Anna Cecilia Bettencourt**

You have to take into consideration that the deliveries will be higher in the Second Quarter with some of the costs that are related to the -- our industrial costs will be in a certain extent diluted during the quarter.

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

Then, secondly, Freddie, could you -- I guess since we all spoke to you last month up in New York, update us on how the markets look, the aircraft markets globally, selling campaigns, I guess, both for commercial and for executive jets?

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

Yes, sure. Well it hasn't changed. So let's say that the positive outlook that I mentioned to you -- without going into any specifics, of course -- remains there. We still see some positive trends for sales on the business jet side. On the airline side, we have -- of course, we have divulged this Japan Airlines deal, which is not accounted in the backlog yet, but we hope it will be in this quarter as we execute the contract.

The Lufthansa order also, although it is -- will not change our total number of aircraft in our backlog, there may be some little bit of increase in terms of value due to the mix. This is a 190 order vis-à-vis the old suites [ph] order of 15 170s and then 15 195s. And there are

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promising campaigns going on right now. So qualitatively, I would sustain what I told you. We are optimistic about our ability to have another quality year of sales.

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

Do you feel like -- do you feel optimistic going into the air show?

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

Well we may -- we may reach -- Japan Airlines definitely we hope to have this signed before the air show. But I mean it's been a while that particularly I was never very fond of holding information for big splashes in the air shows. So as we have orders, we will be talking about that. If it coincides with the air show, fine. But this is not a specific target of ours.

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

Okay. I'll let someone else go. Thank you.

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

Thanks.

**Operator**

Sir, our next question is from Heidi Wood, Morgan Stanley.

**Q - Heidi Wood** {BIO 3095506 <GO>}

Good morning. I have three questions. First, I wanted to try and understand this uptick in labor production costs. It looks like year-over-year it increased by \$25 million, and you cite the addition of 2,000 employees, which I may be not looking at it the right way. But that sort of suggests \$12,500 in additional costs per employee. And first of all, that seems high.

And given that you're talking about hiring another 1,500 more people, I'm just wondering if that means that there's another \$18 million or so in additional labor production cost headwind that you'll be facing through the rest of the year as you engage in training those folks. Is that kind of what you're facing going forward?

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

Heidi, I haven't done those calculations. So I'll ask Anna. Do we have any --?

**A - Anna Cecilia Bettencourt**

Heidi, it's important -- I mean, the number of employees that were hired, they were; I mean, you have to take into consideration that they were producing a smaller number of aircraft because they will be addressing future deliveries and future capability toward the end of the year.

So it's not this is something that will be working in a way that will be increasing production. So their costs will be diluted based on the higher number of aircraft delivered.

**Q - Heidi Wood** {BIO 3095506 <GO>}

Right. No. I understand that on the production side. I'm just trying to better understand, get better granularity of the cost side. I mean, is that a fair way to look at it, that it's about \$12,000 in terms of net labor production costs per employee?

**A - Anna Cecilia Bettencourt**

No, no, no.

**Q - Heidi Wood** {BIO 3095506 <GO>}

All right. So maybe I'll ask about more on that offline. My second question is can you break out the entire selling expenses between the 190 rollout and the buildout in business jet sales that you saw?

**A - Anna Cecilia Bettencourt**

Well selling expenses -- do you have it open?

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

No. Not yet. Between products, no.

**A - Anna Cecilia Bettencourt**

No, no, no. What is commercial and what is business jet?

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

Positively, obviously we are still facing a much higher selling expense on the business jet side. I don't have the breakdown with me here. But we just have the Legacy 600 as the source of income, and we are ramping up the whole infrastructure for the Phenoms and the Lineage and the sales marketing, et cetera.

So although I don't have the number, this number is still -- unbalancedly and negatively affected by this. That's called the setup of the business jet.

**Q - Heidi Wood** {BIO 3095506 <GO>}

No, absolutely, Freddie. I'm just thinking when I think of your higher selling expenses, you're on sort of the right-hand side of the bell-shaped curve on your 190 rollout expenses, and you're probably on the left-hand side of the bell-shaped curve on your business jet buildup. And so I'm just trying to understand those tradeoffs so I can have a better sense as to -- again, I'll ask that offline.

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So my third question, maybe I'll get lucky here. Freddie, I'm wondering, there are two initiatives that are happening in Washington I wanted to get your opinion on. Bush's plan to raise taxes on more of the executive aviation and business jet operators and cut the taxes on the airlines. And also this week, the Senate Commerce Committee is going to be voting on corporate flight taxes. And do you guys have an opinion as to kind of how that is apt to affect demand going forward, if at all?

I mean, do you think that -- does it look like the tax effect is incremental and won't impact demand, or do you think this is something that we should be paying attention to?

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

Well this is a development that at this stage is hard to predict. I mean, there are strong lobbies on both sides. I mean, we are, of course, interested in both. The airline business is the largest part of Embraer business, and it will keep being the largest part of the Embraer business.

The sensitiveness of the business jet demand as a result of any potential increase in taxes, I don't think there is any clear model about that.

**Q - Heidi Wood** {BIO 3095506 <GO>}

Okay.

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

All of our forecasts, and of everybody that I talk to, remains very bullish on the business jets beyond -- actually, there is some discussion about there may be some new correlation between GDP growth and business jets in a positive way. I have not seen anything specific about a potential impact of a different taxation to those models. I am not sure there is something out there at this stage.

**Q - Heidi Wood** {BIO 3095506 <GO>}

Okay. That's helpful because I know with the higher fuel prices, we didn't see that change the business jet demand. So that's why I wanted to get a sense as to -- you would have a better sense than we would on how taxes affect that dynamic.

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

The effect on liquidity really I think is today the comparing factor, and it may -- I'm not fully sure yet -- represent a long-term change in this correlation. But definitely the excess liquidity in the world is modifying the landscape and the demand for business jets is just unbelievable.

**Q - Heidi Wood** {BIO 3095506 <GO>}

Okay. Great. Thanks very much. I'll let someone else get a question.

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## Operator

Sir, our next question is from Ira Talin [ph], Prudential Equity.

**Q - Byron Callan** {BIO 1498699 <GO>}

Yes. It's actually Byron Callan. Good morning, everybody.

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

I'm wondering who was this new guy.

**Q - Byron Callan** {BIO 1498699 <GO>}

Yes, my twin brother. A couple of odds and ends. First, inventories, you'd still expect those to decline through the year based on the delivery pickup in the back half, maybe we're close to \$2 billion by the end of 2007?

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

Yes. That's still the figure we are looking for, yes.

**Q - Byron Callan** {BIO 1498699 <GO>}

Okay. Customer services year-over-year was down slightly from a sales basis. Is there anything going on there? Is it just kind of a timing or comparison issue, or can we talk about that a bit?

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

Yes. It's actually not going down, is it?

**A - Anna Cecilia Bettencourt**

No. What really happened this quarter comparing to First Quarter, that First Quarter 2006, there was other sales -- sale for used aircraft which this quarter did not happen.

**Q - Byron Callan** {BIO 1498699 <GO>}

Okay. So sequentially, we see improvement from --?

**A - Anna Cecilia Bettencourt**

Yes. It was more or less the same. The dollar amount was more or less the same.

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

But year after year, Byron, if you go back let's say to '04, the 200 -- through 200-ish level and no five, moving up to the 400 level and 500 last year, of course, there was a huge step function there with the acquisition of OGMA. But we -- no, we don't think this little reduction the First Quarter is representative of a trend.

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**Q - Byron Callan {BIO 1498699 <GO>}**

Okay. Good, good. Two more quick things. You guys have come out more formally on the C-390 aircraft proposal, the military transport. Where do you think that goes? I mean, you'll talk about it, I'm sure, at Paris Air Show. But is it a factor in how we should think about things for 2007 and 2008 in terms of research and development expenditure or any kind of investment you guys might have to make? Is there any potential for a customer announcement on this? Go ahead.

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

No. It's certain preliminary. We are spending -- I mean, there will be no surprises to our research and development investment. Of course, if we do launch -- if and when we do launch this program, this will certainly represent an additional investment, which is not today in our forecast.

Having said that, we are going on -- on the critical path of the let's say pre-design phase, which is basically to evaluate considerations, talk to potential customers, make sure that let's say that the aircraft side is well taken care of. There's a big challenge there, of course, to put together a funding process because the Company will not fund this program at risk, as we do, of course, with civil products.

But the responsiveness of let's say potential users, operators, et cetera, is very interesting. So it looks like we may have an interesting product. But I think there's still a long way to go to put together the financial structure and the industrial partners to consider the actual launch of the C-390.

**Q - Byron Callan {BIO 1498699 <GO>}**

Okay. Then just my last one, kind of related also on the defense markets. What's new? The RF I think had come out and said they wanted to replace their Tucano fleet. I know that's kind of the end of this decade, next decade. Singapore had made a decision on the G 550 platform, but I don't think you guys were in that competition.

I mean, what else is going on that may be different from when you talked to us in New York on April 11th on the defense market?

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

If you take that reference that's not really -- nothing really new. I mean, we were, indeed, in the Singapore bid, and we did not win. No. The Turkish procurement we bid, believing this will be decided this year, sometime in the mid or second half of this year.

But there's nothing new that we should add at this day from what we discussed in New York.

**Q - Byron Callan {BIO 1498699 <GO>}**

Okay. Thanks a lot.

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

Thank you, Byron.

**Operator**

Sir, our next question comes from Ron Epstein, Merrill Lynch.

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

Yes, hey. Good morning. Fred, you alluded to other supply chain issues, and I think in the press release you guys mentioned that, too. Is there anything else going on besides the transition of the wing production?

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

Ron, the wing was by far the issue. I mean it was the issue last year. And having a production background, I really have to look at everything else as well. As I said and represented before, we don't have any -- we don't expect any surprises as we had with the wings. It's relative in the short term -- I mean, last year we kind of realized that we had a problem.

To avoid that to happen, I mean, I'm really going deeper and deeper and making sure that any potential bottleneck -- of course, as you decrease the level of the river, all the rocks start to show up. So my work is to make sure that everything that could eventually be a detriment to our effort to get our deliveries is previously taken care of in that event.

So this is why we mentioned -- gave some more information than we gave in the past. But that does not mean that the thing that we found out now. I'm just trying to give you a little bit more clear perspective of what we are doing, working on the subcontractor side. We are expanding -- those are machine parts, most of them made in Brazil. So we are expanding the base.

We cannot be at correspondent's [ph] training capacity. It's better to work with some overcapacity, if you will. I mean, for example, on the nose of the aircraft, there was a need to duplicate another jig, which was a little bit close to the edge. So we're doing that as well. And of course, the integration of the personnel. This investment that we're doing in terms of training will pay off in the future in terms of productivity, and of course, we would never even talk about any potential compromise to quality.

So it's a burden now, but it will pay off in the future as we streamline our production. So I'm working several different fronts. But we definitely do not see today any showstopper as Kawasaki was in the past.

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

And if you would characterize how the wing production is going now that you have it in-house? Has it stabilized? Is it increasing? How would you characterize it?

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

It's increasing. As I said, we did have a delay in the fourth jig. If you remind, we have two jigs that we inherited from Kawasaki. The third jig is already producing wings. Next month, for example, the month of June, we'll be probably receiving 11 to 12 wings already. So it is happening.

And the fourth jig will also be implemented very soon. I don't have a precise date here, but it's imminent. So we really expect to have this wing issue fully resolved from now on. And as I said, I mean, we are already starting to receive a significantly higher amount of wings month by month. So it's encouraging -- it's under control now.

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

Okay, okay. Now another question, just I think is a follow-on to one of Heidi's questions. When you look at the selling expenses, they were, I think, ahead of what I was looking for, probably other folks, too. And you referred to the increased spending on the business jet side of things.

When do you expect that to return to a kind of a more normalized run rate? I mean, when would you expect the startup costs for selling to start to abate on the business jet side?

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

Well 2008 on, Ron, we'll start delivering the Phenom 300 -- sorry, Phenom 100 and maybe one or a couple of Lineages. '09, we'll see a more significant ramp-up. So I mean, last year, take the total selling expense about 10%, that is pretty much what we have planned for this year and next year. So the future would look more like a stable fit [ph] for the next couple of years.

Sorry, Antonio is saying something here. Yes, of course, and beyond that, Antonio is just calling attention -- beyond that, as we -- of course, as we ramp up the revenue, the plan would be to have a decrease on those costs. But for the next two years, this year and next year, I would probably look at a stable, around 10% selling expenses.

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

Okay, okay. Then just one last question, if I may, you mentioned and also in the press release, there was an increased level of overtime work. What was that on?

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

Well pursuing the labor is on time, basically. I mean, integration of people. We -- for example, we have people dedicated to helping those youngsters through kind of a coaching program. And of course, as we are in the recovery mode, clearly. We are recovering delays, and that requires really working more than the normal hours.

So as we have this whole -- this will be there for I think still for a few months. I mean, it's a recovery mode, and we just are trying very, very hard to fulfill our commitments in terms

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of delivery dates.

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

Okay. Great. Thank you.

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

Thank you.

**Operator**

Sir, our next question is from Christine Min, Calyon Securities.

**Q - Christine Min** {BIO 5802066 <GO>}

Hi. Good morning, everyone.

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

Good morning.

**Q - Christine Min** {BIO 5802066 <GO>}

You recently announced that you increased the selling price of the Phenom 100 by about 4.5%. Can you explain the drivers behind this?

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

Well it's -- basically, let's say a more certainty that there is elasticity in the price with offer and demand. So it's a move towards responding to the market acceptance and exercise some elasticity in our pricing. The Phenom is -- today the challenge, actually, in terms of sales is related to delivery date. We pretty much have all slots committed through sometime late '10.

Even with that perspective, usually business jet customers, they're not much -- they don't want -- they don't like to wait too much. But even so, we still see increasing demands for the Phenom 100.

So we just thought it's not such a high jump in our price, and the aircraft is still very, very competitive if we compare the Phenom 100 to its actual let's say peer, which would be the Citation 1, which is priced in the north of \$4.5 million, when you compare aircraft against aircraft. So the elasticity is there. And of course, we do not want to create any disruption in the market, but we do want to take some benefit from that elasticity.

**Q - Christine Min** {BIO 5802066 <GO>}

Okay, excellent. And also -- this is a more granular question -- but clearly, the gross profit margins and operating profit margins were impacted more by the production ramp-up

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issues. But how much can you say was attributable as well to the appreciation of the Brazilian currency?

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

Yes. There was some appreciation. Maybe Anna can give the precise number. But that was also a factor.

**A - Anna Cecilia Bettencourt**

It was about a 0.5% impact this quarter on our gross margin.

**Q - Christine Min** {BIO 5802066 <GO>}

Okay. Great. Thank you.

**Operator**

Sir, our next question is from Stephen Trent, Citigroup.

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

Good morning, all. Just one or two questions from me, as most of my questions have been answered. Not to beat a dead horse here, but just looking again at the selling expense. Certainly you guys are now doing a lot more selling outside the United States than you did before, and I'm wondering to what degree you're seeing currency noise in the higher selling number?

Is there currency noise, or are you still doing a lot of that sort of based out of Florida, for example?

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

I don't think so, Steve. I don't think there is anything significant in that extent. It's really related, I think, on the rate of sales, the actual revenues against the costs, which are pretty much fixed costs. There is some variable components, but I would not say that that's different from one market to the other.

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

Okay, fair enough. And just one more question from me. Last quarter, you did give us a very nice update in terms of options for firm orders and sort of the basic expected pace of expiration, customer option as we moved through the year. Can you kind of give us a picture as to where we are with that?

You mentioned some option expirations coming up and sort of what does the pool [ph] potential from orders relating to option exercise look like over the next several months, for example?

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

Well 2007, I mean, we are, of course, fully booked, and my real challenge is to make sure that we do deliver what we have committed to deliver. '08, there are -- I mean there have been some options already exercised. I mentioned recently Virgin Blue. I mean, out of those options, some -- I don't know exactly how many -- but some fall into late '08.

We still have some open -- not open, some options which are still due. I mean, the exercising date is still due sometime the next -- probably next couple of months, which, of course, will be, what can I say, we're just waiting for the customers to decide. If they do decide to confirm those options, '08 would be pretty much taken as well.

So the outlook for 2008 in terms of firm deliveries is very, very positive. Probably I don't recall having this let's call comfortable situation, if you will, in the last several years. But -- so beyond that, it is really premature to make any forecasts. It's been -- as we saw in '04 and '05, it's been more on the positive side in terms of the options that has much more being -- we have seen much more confirmations than expirations over the last -- since the beginning of the E-Jet program.

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

Okay. Great. Thanks very much, guys.

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

Thank you.

**Operator**

Our next question is from Mike Schwabe, Artha Capital.

**Q - Mike Schwabe** {BIO 4802007 <GO>}

Hi. I've got a couple of questions on the pricing side and also on the cost side. On the pricing, I'm wondering if there are any escalation clauses in your contracts at all, which, for example, would allow you to pass on part of the currency appreciation. If the real keeps appreciating, it's through 2 today. So that is obviously something completely out of your control. That's one.

Two is, do you plan on making some formal price increases in any of your lines? And if not, are you seeing the ability to just price those better, even if it's not a formal increase in prices?

Then the last question really on costs. Brazil, as an economy, is actually doing pretty well, and I'm wondering if there are some cost increases, inflationary cost increases as a result of that, especially as regards to labor?

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



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Okay. So taking in the same sequence, escalation? No. We -- all of our indexes are based on U.S. indexes, both for labor and material. So and you can imagine with the inflation we had in this country 10 years ago, it would be a hard call to convince anyone to use Brazilian indexes. So we are pretty much tagged to the U.S. -- to some U.S. indexes in our escalation formula, and we do have, of course, escalation factors in all contracts.

As far as price increases go, I mean this is a continuous effort, but we have to be realistic about the pressures out there. So I just mentioned about the Phenom 100, which is a that's a nice example of what we can do if we manage our pricing policy well.

But of course, the competition is very fierce. So I would not project -- I would not see, let's say, a threat to our pricing levels today. But I think it would be over optimistic to assume that we have room or significant room for price increases which would make a difference in our numbers.

We, of course, readjust list prices every year. But actual deal prices are very much a function of every transaction.

**Q - Mike Schwabe** {BIO 4802007 <GO>}

Okay.

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

On the cost increases, I think you're right. I mean, there is a pressure on the Brazil side of the house in terms of costs. We have managed this issue, I think, in a positive way over the last years, and we'll keep doing that. You know counteracting pressures in terms of, for example, labor costs and with higher productivity and better average as we, of course, hire younger people and as we hire youngsters and people at the early stage of their career, that helps us to keep our balance in terms of cost.

But there is a pressure there, but it's manageable. We have been doing that.

**Q - Mike Schwabe** {BIO 4802007 <GO>}

Would you give us -- I don't know, maybe just give us an example of what the -- maybe an average number of labor costs could be up in 2007? Let's say for the same person who was there in 2006, some average employee if that exists?

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

I don't have that. Just one second, please. Yes, maybe, Marcello, you want to -- last year, November?

**A - Marcello Rodrigues** {BIO 15823412 <GO>}

Yes, last year, the wage was raised in 5% round figures in reals, raised in reals.

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**Q - Mike Schwabe** {BIO 4802007 <GO>}

Okay.

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

It's usually -- it's usually, Mike, it's close to the Brazilian inflation. Some call it spread or that. It's a human negotiation, the employees and, of course, the Company. So it's adherence to the inflation in Brazil, which is a low single-digit forecast for this year.

**Q - Mike Schwabe** {BIO 4802007 <GO>}

Okay. Great. Thank you.

**Operator**

Excuse me. Our next question comes from Mr. Bernardo Carneiro with Deutsche Bank.

**Q - Bernardo Carneiro** {BIO 4037872 <GO>}

Hi. Good morning, everyone. Basically, I have two questions. The first one would be like to address a former question made on the impact on gross margin due to the inventory change. I read again the press release. Within an impact of 1.5% out of the gross margin or 1.5percentage points, meaning 150 bp reduction in the gross margin? Thanks.

**A - Anna Cecilia Bettencourt**

Which one? The reduction, it came down -- it represented 1.5%, which means 150 basis points decrease in our gross margin.

**Q - Bernardo Carneiro** {BIO 4037872 <GO>}

Okay. The second one, I'd like to know if the Company will continue to maintain its guidance of 30% gross margin for the Fourth Quarter, even if additional employee base the Company should hire 1,500 employees during the second and Third Quarters? Would that be feasible?

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

Yes. We believe that the planning for the end of the year would be possible to achieve the 30% in the gross margin. Not average for the year, but by the end of the year. The last quarter of the year.

**A - Marcello Rodrigues** {BIO 15823412 <GO>}

As we mentioned before, our expected gross margin for the Second Quarter is the minimum 27.2%. So it's on a trend to reach the 30% at the Fourth Quarter.

**Q - Bernardo Carneiro** {BIO 4037872 <GO>}

So you reiterate the guidance for a 27.2% margin in the Second Quarter?

## A - Anna Cecilia Bettencourt

Minimum of.

## Q - Bernardo Carneiro {BIO 4037872 <GO>}

Okay. Last question would be I'd like to have some color as guidance for revenue recognition in the defense market, I don't know if everyone was expecting such revenues that you booked \$37 million in revenue in the defense market. Would you give us some number for the entire 2007 for revenues?

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

Is there some second, please?

## Q - Bernardo Carneiro {BIO 4037872 <GO>}

Yes, regarding the recognition of revenues, I'd like to have some guidance on the defense.

## A - Anna Cecilia Bettencourt

Yes. It would be -- I mean, around 5% of the total company sales, our net sales for the year.

## Q - Bernardo Carneiro {BIO 4037872 <GO>}

Okay. Thank you.

## Operator

(Operator Instructions)

Sir, our next question is from Robert Pickels, Manning.

## Q - Robert Pickels {BIO 16153519 <GO>}

Good morning. My question is on the backlog. It looks like the backlog was up slightly during the quarter despite delivering more aircraft than you took orders for. So obviously - I'm just wondering if you could give a little bit more detail on where that backlog increase comes from, even though it's slight?

I'm guessing it's the business jet area, but is it the Lineage? Is it the Legacy, the Phenom? Maybe just a little bit more color there? Thank you.

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

Yes. It's -- I don't have the precise figure, but it's certainly centered into the executive jets. I would say Phenoms and Legacies. Maybe there's a -- I'm not sure about Lineage, but I'll say in the Phenoms and the Legacies.

**Q - Robert Pickels** {BIO 16153519 <GO>}

Okay. Thanks.

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

And just, sorry, on the last question, Robert -- just to add, I do have now information that I didn't. There is also some Lineages in the backlog increase. We have some Lineage sold as well this quarter.

Everybody there?

**Operator**

Sir, our next question is from Dan Khoshaba, KSA Capital.

**Q - Dan Khoshaba** {BIO 1504475 <GO>}

Hi. Good morning. You've kept your deliveries at 165, 170 for the full year. If I pull out the business jets, which I guess is about 27 or so, you should have about 140 commercial jets. We had 25 in the First Quarter. What is the succession of deliveries going to look like over the next three quarters?

**A - Anna Cecilia Bettencourt**

As we mentioned, we expect to see during the First Quarter 40% of the Company's deliveries happen in the first half of the year. Then 60% in the second half of the year.

So if you look to the numbers already delivered, the aircraft already delivered, 25, there would be around in the Second Quarter around 40 or 38, 40 aircraft during the Second Quarter.

**Q - Dan Khoshaba** {BIO 1504475 <GO>}

So to get there, though, all these employees that you hired -- 2,000 -- another 1,100 have to be kind of fully trained, up and running third shift really within the next kind of eight to ten weeks to be able to produce for the second half all those planes. Is that correct?

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

Well I'll say this is, of course, a continuous process and to reach its full maturity by sometime in the Third Quarter. So of course, when Anna talks about 38, 40 deliveries in this quarter, Second Quarter, I mean this is already a result of what we have done in the past. So yes, sure. For the rest of the year, we must have by -- I don't have the precise week or month, but sometime the Third Quarter, we definitely have to have everything in place to reach that 165 to 170 level.

**Q - Dan Khoshaba** {BIO 1504475 <GO>}

At the beginning of the quarter, what were your expectations for deliveries?

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

Which quarter?

**Q - Dan Khoshaba** {BIO 1504475 <GO>}

This last quarter one, the one that you just finished. I mean, you delivered 25. That missed expectations, I think, for most people who follow you closely. They thought you'd deliver more. But the question is when you started the quarter, at the very beginning of the quarter, how many planes did you think you would deliver during the quarter that you just finished?

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

Maybe three or four aircraft more.

**Q - Dan Khoshaba** {BIO 1504475 <GO>}

Three or four aircraft more? Okay. Thank you very much.

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

Yes. This is an average. Yes.

**Q - Dan Khoshaba** {BIO 1504475 <GO>}

Thanks.

**Operator**

Sir, our next question is from Joe Nadol, JPMorgan.

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

Thanks. I'm just following up on the selling expenses. I know this question has been asked a bunch of times. But just going through my model, you kind of said that selling expenses we should look at a 10% number going to next year. Your sales are growing quite a bit, and some of the selling expenses really are not directly related to sales you're making in the quarter, but rather other issues.

So as we look to sales growing in the \$6 billion range next year, 10% of that is \$600 million. That's a run rate still of \$150 million a quarter, which is way above where you are. So are you indicating that selling expenses are going to go up materially from here, or is there something else I'm missing?

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

Joe, it would be possible to consider the amount of dollars for this quarter is more or less the same amount of dollars you have for the next quarters.

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

Okay.

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

And for the next year, not going to change deeply because the borrower put the Legacies in the same (inaudible) more than we have today. The amount of dollars is more or less the same.

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

Okay. So when your sales go up, it should decline as a percentage of sales?

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

Yes. The percent is going to decline.

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

Okay, I just wanted to clarify that. Thank you.

**Operator**

Our next question is from Heidi Wood, Morgan Stanley.

**Q - Heidi Wood** {BIO 3095506 <GO>}

Yes, I just wanted to get a sense when you look at the backlog across the E-Jets, 7% of the backlog is the E 170, and I just wondered kind of what you see happening there? I mean, is it just the profile of the airlines today kind of heading towards the 190, 195? Is that sort of a cyclical phenomenon, or do you think that's sort of a secular shift towards the 190, 195?

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

Yes, I think there's a structural trend toward larger aircraft. We do expect the 190, 195 to become the main seller of the family. And keep in mind, the 175 is now, if we have to call it scope clause aircraft, a 75-, 76-seater aircraft, that is more the 175 size than the 170.

So as they are actually literally almost the same aircraft, the 170, 175 and the 190, 195, I think we are well covered throughout the range. But structurally speaking, I think scope is pulling demand for the 175 higher than the 170, and the general trend for larger aircraft is boosting the demand for the 190, 195.

**Q - Heidi Wood** {BIO 3095506 <GO>}

All right. So then that backlog of the -- 75% of your backlog is keyed to the 190 and 195. So you expect over sort of the life of the program that's kind of probably what we're going to be seeing by way of profile?

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

Heidi, it's really hard to make -- if you ask that question three times over the last six years, probably myself and everybody else would give you three different answers. This thing has evolved. The 170 in the beginning was the big seller, and then the switch.

So today, yes, I would agree with you. This would be the vision today that the predominance would be the 190, 195. But of course, if a single major airline in the United States decides to go to a large acquisition of scope clause original jets, that can certainly affect this whole thing I'm talking about and boost the demand for the 175.

So it's hard to be precise in your question. But yes, the trend, what we see today is a 195 dominating, 190, 195 dominating the demand.

**Q - Heidi Wood** {BIO 3095506 <GO>}

All right. Great. Then one quick question. I think it was answered before, but I think I missed the answer. Which is how many non-complete aircraft do you have in inventory? I'm just trying to back out, understand your inventory a little bit better.

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

Just a second. Marcello is checking here.

**Q - Heidi Wood** {BIO 3095506 <GO>}

I mean, are there a number of test aircraft still in inventory there? Or just if you could break that out for us?

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

Yes. We have the majority of the aircraft that we have there is still in the working capital. It's almost finished, but it's not finished really because we consider it finished other the certification of the CTA. We do not anticipate the certification if we don't have it totally ready. But at the end of the month, the quarter, we have \$31 million finished aircraft.

**Q - Heidi Wood** {BIO 3095506 <GO>}

Okay. Great. Thanks very much.

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

Thank you.

**Operator**

And sir, our last question is from Dolly Cranin [ph], a private investor.

**Q - Unidentified Participant**

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Hello. I'm a private investor. And I did not have the advantage of seeing the press release, and I just wanted to confirm what your gross revenues were and the EPS per share.

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

Okay. Revenues.

**A - Anna Cecilia Bettencourt**

Gross revenues of \$843.3 million -- \$843.4 million, EPS of \$0.14 per diluted ADS.

**Q - Unidentified Participant**

Okay. Thank you. And I would just like to -- recently, I flew on one of the small commercial jets, and I am a commercial jet flier. I just wanted to compliment you on what I thought was an elegant design that was very smooth and quiet. And coincidentally, in the next several days, I was in a Citation, and there was a very similar feeling in terms of style. And so I congratulate you.

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

We appreciate your kind words. Thank you.

**Q - Unidentified Participant**

You're welcome.

**Operator**

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

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

Well I'd like to thank you all for your attention. We kind of had already anticipated that this would not be a great quarter, as it wasn't.

As we mentioned during the questions and answers, we did expect a couple or three more aircraft to be delivered in the First Quarter. But all of the measures that we are taking in our production chain gives us confidence that our guidance of 165 to 170 is doable by this year. And of course, we have an important checkpoint next quarter.

So I do hope and we're working very hard towards in our next earning call of having news that will more solidify what I'm talking about. So again, thank you all. So thank you all for your consideration.

**A - Marcello Rodrigues** {BIO 15823412 <GO>}

Thank you very much for our side, too.



## A - Anna Cecilia Bettencourt

Thank you. And we'll talk next quarter.

## A - Antonio Luiz Pizarro Manso {BIO 1845027 <GO>}

Thanks very much.

## Operator

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

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