

## Q1 2016 Earnings Call

### Company Participants

- END (10)
- Eduardo S. Couto, Director of Investor Relations, M&A and New Businesses
- Frederico Pinheiro Fleury Curado, President & Chief Executive Officer
- José Antônio de Almeida Filippo, Executive Vice President-Finance & Investor Relations (CFO)

### Other Participants

- Alexandre P. Falcao, Analyst
- Bruno Amorim, Analyst
- Cai von Rumohr, Analyst
- Derek Spronck, Analyst
- Joshua Milberg, Analyst
- Marco Antonio Spinar, Senior Vice President
- Myles Alexander Walton, Analyst
- Peter John Skibitski, Analyst
- Stephen Trent, Analyst

## MANAGEMENT DISCUSSION SECTION

### Operator

Good morning, ladies and gentlemen, and welcome to the audio conference call that will review Embraer's First Quarter 2016 Results. Thank you for standing by. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session, and instructions to participate will be given at that time. As a reminder, this conference is being recorded and webcasted at [ri.embraer.com.br](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 believes, may, will, estimates, continues, anticipates, intends, expects and similar words are intended to identify forward-looking statements.

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

Participants on today's conference call are Mr. Frederico Curado, President and CEO; Mr. José Filippo, Chief Financial Officer and IRO; Mr. Eduardo Couto, Director of Investor Relations.

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

## **José Antônio de Almeida Filippo**

Okay. Thank you and good morning, everybody. And thanks for joining Embraer first quarter 2016 conference. As we've been doing in the past, we're going to do the presentation and then be ready for the questions.

So starting the presentation, page three, the highlights and starting with the institutional highlights with the information that Fitch Ratings started coverage of Embraer with investment grade rating of BBB-. Also, Standard & Poor's reaffirmed our BBB rating investment grade. Now, we have coverage by three rating agencies.

Next page, page four, moving to operating highlights and starting with Commercial Aviation. We had a total delivery of 21 E-Jets in the first quarter, which included the first E175 to KLM of the order of 17 firm. Regarding customer activity, the Austrian Airlines became a new E-Jet operator. And we announced early this month that Horizon Air ordered 30 E175, which will fly for Alaska Airlines.

In relation to the E2 development program, two important updates. The E190 prototype undertaking ground tests ahead of the first flight in the first half of this year. As you remember, we had the whole of rollout in early February. Also, we started the production of the first prototype of the 195 model.

Next page, page five, now talking about effective aviation highlights, the delivery of 23 jets in the first quarter of 2016, including the first delivery of the Legacy 500 in China. An important milestone in Executive Jet business was the delivery of the aircraft number of 1,000, which was a Legacy 500 to Flexjet. Regarding sales activity, we selected across as Embraer sales representative in Mexico.

Next page, page six. Moving to Defense & Security business, regarding the KC-390 program, the second prototype joined the flight test campaign the first flight yesterday. Also, the first prototype is already performing a ramp open testing flights (04:45).

In relation to the Defense company's activity, first, in the development of the Brazilian satellite, Visiona signed six contracts for remote sensing services. On radars, we signed

contract with the Brazilian Navy to develop Gaivota-S prototype radar.

And finally in Defense, our activity in supporting the upcoming Olympic Games in Brazil, Atech concluded the air traffic control and message systems tests.

Next page. Now talking about the financial results, let me move to page eight with the firm backlog numbers. We reached the total of \$21.9 billion in the end of March, slightly below the end of last year but above the first quarter of 2015.

Next page, page nine, as far as aircraft deliveries. Starting the left chart, Commercial Aviation delivered 21 E-Jets in the first quarter. And in the right side, Executive Jets, 23 deliveries in the fourth quarter broken by 12 light jets and 11 large jets. We are reiterating our outlook for the year of 105 to 110 E-Jets, 40 to 50 Executive large jets, and 75 to 85 Executive light jets.

Next page, page 10, net revenues. We had a total of \$1.3 billion in the first quarter, equivalent to R\$5 billion. And also, for the 2016 outlook, we are maintaining our range between \$6 billion to \$6.4 billion in terms of net revenues.

Next page, page 11, revenue broken by business. From the top right, in Commercial Aviation, we had total of \$711 million in the first quarter; to the bottom, \$189 million in Defense; and further left in the bottom, \$402 million in Executive Jets in the first quarter. For all of the business, we are maintaining our guidance range for 2016.

Next page, page 12, regarding SG&A expenses. We reported a total of \$140 million in the first quarter. In relation to G&A, we had a total of \$39 million below the same period of last year. And on selling expenses, \$101 million in the first quarter 2016, above the same period of 2015, reflecting primarily the high number of deliveries.

Page 13, next page, in relation to operating income. We reported a total of \$86 million in the first quarter with 6.5% margin, which combine the positive 12.3% in Commercial Aviation, and negative 1.5% in Executive Jets, and the positive 2.2% in Defense. Regarding 2016 outlook, we are confirming our estimate of \$480 million to \$545 million with a margin of 8% to 8.5%.

Next page, as far as EBITDA, we reported a total of \$168 million in the first quarter with margin of 12.8%. For EBITDA, we are also confirming our estimate for the range of \$800 million to \$870 million with a margin of 13.3% to 13.7%.

Moving to next page regarding net income, we reported a profit of \$104 million in the first quarter of 2016 with a 7.9% margin. As we've been observing in previous quarters, this result was impacted by the exchange variation in the income tax. In this quarter, we had a positive impact.

Next page, page 16, in relation to investments, we had a total of \$52 million in the first quarter broken by \$7 million in research, \$12 million in development and \$33 million in

FINAL

Bloomberg Transcript

CapEx. These figures are net of contribution of suppliers, and for 2016, we are estimating the total of \$650 million for investment.

Next page, page 17, regarding free cash flow.

## END (10

00)

contribution of suppliers and for 2016 we are estimating the total of \$650 billion for investment.

Next page, page 17, regarding free cash flow. We used \$216 million in the first quarter, primarily reflecting the normal increase of working capital in the beginning of the year and the investment in the development of the E2 program. For 2016, we are estimating the use of \$100 million or less.

Next page, finalizing the presentation before the Q&A section, our capital structure. We reported a net debt of \$220 million in the end of March with \$3.4 billion in cash and \$3.6 billion in debt. In relation to our debt profile, we are maintaining a comfortable maturity term of almost six years.

Okay. With that we conclude the presentation and now we're ready for the Q&A. Thank you.

## Q&A

### Operator

Thank you. Your first question comes from the line of Cai von Rumohr from Cowen & Company. Please go ahead.

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

Yes, thank you very much. So, good results. Can you tell me - can you give us some color on what you're seeing in terms of demand in the biz jet market, I think others have said it was particularly slow in January, February but it has gotten a little bit better since then?

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

Hello, Cai. Yeah, we see also some softness; no real change from the last quarters. The U.S. market continues to be the - where most of the activities but some softness there. Also the risk, as we have said before, some pricing pressure on all OEMs. So, but stable is the way I will describe it.

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

FINAL

Okay. Thank you. And then the last one, you know, now that your competitor has won Delta and I guess IAG is talking to them. What are you seeing as a result of – in your RJ and in your kind of commercial air transport market both in terms of opportunities and in terms of any changes you might have seen in terms of the pricing there?

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

Well, I think of course Delta was a very important campaign and no way I want to diminish the importance of that campaign. But it was somewhat atypical. It was not a straight race between the 75 new aircrafts. So in our case, the offering as requested by Delta was a combination of new and used aircrafts. We remain very convinced that we have an extremely competitive product family, both in E1 and down the road in the E2. We were very aggressive in the campaign.

I believe, although of course we do not know the details of the competitive bids, the onerous contract provision of \$0.5 billion for some contracts (13:46) I think already says a lot about where the decision came from. So we remain competitive but also disciplined as far as the integrity of our product portfolio and our backlog, and of course and our cash position and balance sheet.

So we're not discouraged at all about this result. And we remain, as I said, very comfortable with the competitiveness of our company and our products.

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

Thank you very much.

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

Thank you, Cai.

**Operator**

Thank you. Our next question comes from the line of Myles Walton from Deutsche Bank. Please go ahead.

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

Thanks. Good morning. I was wondering if you could talk a little bit about the demand picture in the Defense environment. And in particular, as it relates to the KC-390 with the second aircraft in the air, does that get you closer to a point where international campaigns can kind of come to fruition?

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

Good morning, Myles. Yes, well, first on the development side, which is very important, not to miss our deadline of certifying the aircraft by end of next year, so we can start deliveries in 2018. Everything is going fine. Second prototype will fly – has flown, okay, great, yeah. So, yeah. So, and not only this, but also the – some very key flight tests, such as the ramp opening in flights and also the parachutes or the door and opening the

Bloomberg Transcript

FINAL

envelope (15:34). So far we've done extremely well. So, on the development side, we are extremely happy with where we are.

As far as campaigns, there are preliminary campaigns going on. As we all know, this military campaign is typically longer than a Commercial. Having said that, dialogues went on with several potential customers and also with Brazil, because there is this outstanding order of 28 aircrafts. I believe three of them to be delivered in 2018. Budget constraints of course, but as you probably have seen in our financials, we have been able to keep what we've said we would keep our accounts receivable where they are. Payments are regular than now, we have rescheduled the contract. So, it's - we're optimistic about not only the Brazilian - the fulfillment of the Brazilian contracts, but also international prospects. Probably you will see towards the end of the year, early next year we're going to have probably more momentum as far as those sales campaigns.

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

Okay. And Couto, can you comment on the margins at Executives, so it's about - it's a \$15 million year-on-year, \$16 million year-on-year negative swing in operating profit on a \$250 million higher revenue base. But I know the 650s are a big portion of that. But, I mean, were there any negative adjustments to used or anything else that's bringing down that overall EBIT margin. And then give us a trajectory to get to the mid to high single-digit target for the year.

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

Yes, Myles. We're still maintaining that target. What we saw in the first quarter was a mix - a negative mix which included the legacy 650 with the impact to that. Also both of the legacy 650 were a carryover from last year and we also had in the selling expenses couple of non-recurring items there, some \$10 million of non-recurring there. But also the number of deliveries impacted that number as well. So it's a combination of that and that (18:07). So - but it's a portion that we're still confident about the capacity to deliver what we indicated for the full year in terms of Executive Jets margin.

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

Okay. Thank you.

**Operator**

Thank you. Your next question comes from the line of Josh Milberg from Morgan Stanley. Please go ahead.

**Q - Joshua Milberg**

Good morning everyone and thank you for the call. I had a couple of questions on Defense. The first was, while it was good to see your EBIT margins there turning positive this quarter and just wanted to know if you had any cost base revisions in your favor this period? And if not, is that something we're likely to see in upcoming quarters, assuming that the currency stays where it is?

FINAL

## A - José Antônio de Almeida Filippo

Yes, we didn't have any impact in terms of contract revision. As we had last year, we already said that if we see more stability in terms of the currency, we should have this situation, which actually happened. So there was basically only activity in the first quarter. We still think that it is possible to keep in that level and probably like we indicated, like, close to mid single-digit margin in this year.

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

Yeah. Just to add, Josh - it's Eduardo here - to what Filippo said, we do not have any base adjustment as far as FX on Defense. So we use it around R\$390 million for Defense in the first quarter. So as the currency gets stronger, if that continues, we may have the opposite effect of what we had last year when we had negative impacts as far as cost base revision.

## Q - Joshua Milberg

Okay, great. Thanks for that. And then just another question on Defense, is if you could touch on the issue of Defense receivables, the currency move clouded the picture a bit, but we saw in the ITR that the amounts with the government I think were down about 10% sequentially in local currency terms, I mean. So I just wanted to understand what was going on there and what we might expect looking forward?

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

In dollars, with not (20:30) view of any sizable change, \$350 million just for the Defense programs Brazilian government to \$347 million.

## A - José Antônio de Almeida Filippo

In reais, (20:41)

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

It's R\$1.2 billion.

## A - José Antônio de Almeida Filippo

Yeah, coming down from R\$1.3, almost R\$1.4.

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

I think it's a currency related, right? (20:52)

## A - José Antônio de Almeida Filippo

Yeah.

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

Mostly currency-related.

Bloomberg Transcript

FINAL

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

Yeah. In dollars, pretty much the same.

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

Yeah, since the second quarter of last year we have been able to maintain accounts receivable more or less stable, actually slightly down. It came from \$370 million second quarter 2015 to \$347 million first quarter of 2016, so down \$30 million. It's small amount but...

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

About 10%...

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

Yeah.

**Q - Joshua Milberg**

And any developments since the close of the first quarter or anything going on there that might move it better or worse in the next quarters?

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

We - last year we - as we've said during the year (21:39) we did a great effort with our customers within Air Force were the main ones (21:45), but also the Ministry of Telecommunications, the satellite side and also the SISFRON with the Army to really adapt our fleet, our programs (21:57) to the budgetary reality that they could afford and this has been actually followed quite correctly over the first quarter. Our expectation is that we do not have any interruption of this as we all know, I mean, we are facing some political turmoils here in Brazil, where there is an impeachment process in - going on right now in Senate, has already passed the Lower House, so the market in Brazil is reacting very favorably to the potential change.

So one way or the other our expectation is that the commitments which are in place will be respected, at least so - if Brazil - of course if the country gets better, the macroeconomy gets better then of course we would be even more certain that the commitment will be fulfilled and the budget will start to be adjusted upwards and the current fiscal loss will be reduced and the ability of the government to fulfill its obligations will be reinforced. So we are, as I said, what we see ahead is at least the continuation of the first quarter and therefore the achievement of our goals, of our guidance.

**Q - Joshua Milberg**

Okay. Thank you very much.

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

Thank you.

Bloomberg Transcript



## Operator

Thank you. Your next question comes from the line of Ron Epstein from Bank of America. Please go ahead.

Good morning, everyone. This is Mariana Predesmura (23:41) from Ron.

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

Good morning.

**A - José Antônio de Almeida Filippo**

Good morning.

## Q - Operator

Okay. Hello. Hey, in the quarter you signed a long-term agreement for a Flight Hour Pool Program with Colorful Guizhou Airlines, and additional yield spend, \$14 million for the pool program spare parts. Can you talk about your strategy with regards to the aftermarket? How should we think about the size of the parts pool business today and can you quantify the long-term earnings potential for this? Thanks.

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

Okay. Well, all three business units are more and more investing in our after-sales infrastructure and support programs. So it's a - there's a clear strategic view action. And - as I said, in all three business units and the commercial, of course, was the pioneer on this.

We do not believe - we do not report separately the results. We embed everything under each unit. I can say qualitatively it's growing - I am talking here while Eduardo catches some data. But qualitatively it's a growing interest and focus of all our three units. I do not know, Eduardo, if we have any specific figures.

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

It's above 10%.

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

It's around 10% to 15% of revenue.

## Q - Operator

Okay.

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

Yeah, of revenues. And that tends to have, of course, a more predictable and higher margin.

## Q - Operator

Perfect. Thank you very much.

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

Thank you.

## Operator

Thank you. Your next question comes from the line of Alexander Falcao from HSBC.  
Please go ahead.

## Q - Alexandre P. Falcao {BIO 5515455 <GO>}

Good morning, everyone.

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

Good morning.

## A - José Antônio de Almeida Filippo

Good morning.

## Q - Alexandre P. Falcao {BIO 5515455 <GO>}

Hello? All right. Good morning, everyone. So my question is regarding Commercial and the margins going forward. Is it fair to say that if we see FX in the same path, that was going the same levels that we saw in the first quarter, we're probably going to see this is a big margin for the year?

And second relates to comment, is there going to be any shift on deliveries going forward and on this division? Thank you.

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

On the second part, shift to what?

## Q - Alexandre P. Falcao {BIO 5515455 <GO>}

Of mix, sorry.

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

Mix, okay. Well, we - I mean, in the first quarter, the exchange rate - the average exchange rate was exactly R\$3.9, which is a - was a coincidence, of course. That FX exactly is the number we are using in our planning. So that's a good reference to where we can be as far as the margins on Commercial business.

FINAL

Bloomberg Transcript

FINAL

As of course, as FX comes down and the Brazil devaluates, there will be some cost headwinds which we will face as we have faced over the last several years. There's a boost in the competitive - I mean the cost reduction measures. So whether or not at the peak, it's hard to tell. But if you remember, a year ago, we were all discussing that the mix of 175s would bring the margins down.

Less 190s, 195s and more 175s, and we had said that yes, potentially yes, but we would fight very hard on the cost side and also benefit from the standardizing of the fleet because many of those contracts are large-quantity. So we can really have a more standard product and supply chain management.

And there we are, delivering more or less the same margins with fundamentally 175s. So any currency headwinds will be counteracted by additional efforts. We adjust and we do have budgets in reais and dollars separately, so we will probably - we're going to adjust the budget in reais to the new reality of the exchange rate so we do not really just lose this momentum.

About the shift in the mix going forward, this year it's fundamentally 175s. We have activity especially in Asia and Middle East but more so - some in China as well, which are more centered in the 190, 195s. So we may see a different - a little bit different mix in the future, but fundamentally it will be a - the bulk of the demand will be 175s for the last two years that we saw (28:45) 2016 and 2017. The bulk is around 175. We may have some tailwinds of some additional 190s, 195s.

**Q - Alexandre P. Falcao** {BIO 5515455 <GO>}

Perfect. And just one quick follow up, after the Delta and that campaign, (28:27), is there any big campaign in the horizon that you guys could share with us? Thank you.

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

We don't think there is any short-term campaign going on, I mean to be this side (29:15) in the U.S. right now. The potential in the U.S. is too large. There are - we at Embraer still have 120 options of 175s for the next few years. There are still some - what are there (29:29) 300 aircrafts to 400 aircrafts, 50-seater aircraft, which will be replaced in the next several years. And there's also a potential demand for replacement of our early 70-seaters, especially older CRJs, which can also bring additional demand. So, I think the U.S. has been, of course, has seen a great demand for aircraft. I think the campaigns of 2016 most - the largest ones are done, probably - I mean, we don't know, but probably 2017 is when you see more activity again. But also as I said, we see demand going on in Asia, a little bit in Europe, more on the eastern part mainly, and also Africa. And those are more 190, 195s.

**Q - Alexandre P. Falcao** {BIO 5515455 <GO>}

Okay, perfect. Thank you so much.

**Operator**

Bloomberg Transcript

Thank you. Our next question comes from the line of Pete Skibitski from Drexel Hamilton. Please go ahead.

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

Hey, good morning. Hey, guys, on the cash flow for the first quarter, you view substantially less this year than you do in the first quarter of last year and you beat your initial guidance, of course, for the full year in free cash flow. So, I'm just curious, did you think there's a nice opportunity to outperform this year your free cash flow guidance because it's a good starter and then I think some of the things that allowed you to beat last year like supplier contributions and the customer advances and running down the inventory. It seems like, opportunities this year as well. So, just looking for some color there?

**A - José Antônio de Almeida Filippo**

Okay, Pete. Actually, this is something that we'll be very focused on, because it's important in terms of cash generation, all the working capital management and being very close to that. I think that we follow pretty much the standards of the first quarter, which has been increasing in terms of inventory to build the capacity for the deliveries throughout the year, it's naturally.

Then we have a tailwind of suppliers' contribution like we mentioned that positively affected this quarter, that maybe we don't see that in the same level going forward in the following quarters. But basically we are pretty much aligned in what the target that we said, the consumption of about \$100 million or less.

So I don't think that's much changed in terms of, that could be reflected throughout the year. I think this is more like a function of things in terms of the first quarter that will be adjusted in the following four following quarters.

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

Okay. Understood, understood. And then just one follow-up. The Horizon order the last quarter, does that kind of fill out your last available slots in Commercial for 2017 or are there still some available slots - I think you're about 80% filled even before that order?

**A - José Antônio de Almeida Filippo**

Well, there of course we do depend on where we set our production levels. If we think about a stable production level around the 100s, probably we are pretty much done. But the answer to your question to that is yes. We do have - (32:53) available slots, we do have the ability to offer slots in 2017 and of course, we are.

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

Okay. So maybe incremental orders kind of pressure your production rate up a little bit next year?

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

Well, at least to, maybe to maintain where we are, around low 100s, 105 or something like that. So we're very comfortable about keeping more or less the same level where we are and we do have the ability, of course, if we have confirmation within the next let's say, six months or so to raise in the back end of 2017, raise the limit, if we need it.

So - the supply chain and our industrial capability is not limiting our ability to sell maybe even more aircraft in 2017.

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

Thank you very much.

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

Thank you.

## Operator

Thank you. Your next question comes from the line of Derek Spronck from RBC Capital Markets. Please go ahead.

**Q - Derek Spronck** {BIO 17904184 <GO>}

Good morning. Thanks for taking my question. In Defense you're undertaking many different - or new or newer initiatives from the satellite remote sensing service where you've indicated you signed a bunch of contracts recently. How material could these new initiatives grow into if we exclude the KC-390? And which initiative holds the most promise?

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

Well, thanks for the question. I - besides, let's say, the flying object (34:33) on this space, on the military - Defense & Security business. We have those three addition of, let's call it core comp defenses (34:46) and around three different companies, one ATEC, it's really Software House, that's the company which we believe there's a great potential there for further expansion.

And maybe not only into Defense & Security space, but there is competence in software there, which we are assessing and trying to see which are the applications we could use, the know-how that is there.

So, ATEC, that's on the software development side. Then we have Visiona on the space side, so of course, this company started to one single program, one single project which is the geostationary satellite, a huge one, it is more like a PMO (35:34) project. But it's getting momentum, it's getting knowledge and know-how and as you correctly said we did sign some new contracts. So the way we see and want to position Visiona is as the space company of Brazil. So we also see extended opportunities as soon as the economy rebounds.

FINAL

There is of course a second geostationary satellite foreseen for the next two years or three years. But there are also smaller constellation of low-orbit satellites and maybe even other services. And we are also considering discussions with the potential partners so we can boost our ability to acquire technology in space. So Visiona is the second feeler.

And the third, Savis, is the company which is in charge of the SISFRON is our first very broad, very horizontal integrated defense system, so including radars, including acquired (36:48) equipments and the things on the ground and also UAVs, et cetera. So it's also a third competence of integrating complex systems especially for the military and for Defense & Security. And recently we have actually merged Savis with Bradar so it's a company that does have a product portfolio. So as we adjusted our activities to the reality of our main customer, Brazilian Air Force and Brazilian Army, we think we are well-positioned again to - number one, consolidate our portfolio of competence; and number two, really try to make more inroads into the export market.

**Q - Derek Spronck** {BIO 17904184 <GO>}

(37:36) How healthy are the margins on that business there outside of the Defense aircraft line? Are they generally accretive for your overall business?

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

It is. It is - we have a very nice growth story for the last several years. 2015, we were hit by the lack of payment from our main customer. So, let's say and as the world is in conflict there is, of course, a growing activity as far as the military procurement around the world. But it's not only now just acquisition of equipment. It's a lot about systems integration, surveillance, which are some niches where we have products, we have offerings.

So we actually believe this business, which again was hit hard last year by the Brazilian government payables and the reduction also in quantities and (38:43) will resume its growth and again mostly probably for exports from now on. We also, of course, have the Super Tucano now being built in the U.S., and that's also a very good platform for export of other aircrafts into areas of the world where there's a counterinsurgency aircraft is required.

**Q - Derek Spronck** {BIO 17904184 <GO>}

Thanks. Just moving on to the Commercial aero, you have been focused on the E170 with the - you spoke a lot of changes, the E190, 195, sales appeared to be a little bit more challenging recently. If we were to look at the E2, have the market dynamics changed at all when you look at the demand environment for the E2 190, 195s and is the Bombardier C Series, is that - I know they don't compete directly but is it with the Delta order becoming more of a concern for the E2 190, 195?

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

No, we do not see a change in dynamics in the mid to long term. The E2 will enter into market by 2018, the first model. In the short-term, there is - I think there are a couple of important elements in this scenario; one is the very large backlogs of both Boeing and Airbus for MAX and neos. So there is clearly a huge amount of aircraft already ordered.

Bloomberg Transcript

FINAL

And also the reduction in the oil prices has eliminated the urge of many airlines to replace their fleets with more efficient aircraft in the short term. So this is, I think, what we are seeing - what we see across the industry, Boeing, Airbus, the book-to-bill is less than one. And so in the short-term, yes that does not quite affect the E2 and that we are doing well in the (41:00) and we know we are sold out in 2016 and it looks very, very good in 2017 and even 2018. So - I mean, we - the full elements are there and we are crossing this period relatively unscathed and with a strong backlog.

As far as CSeries, the CSeries 100 has a direct competition with our 195-E2. I mean, again, this - we are very sure about the competitiveness of 195-E2. Given of course normal competition conditions both performance-wise and competitiveness-wise, maintenance cost, acquisition cost, the operating cost, the 300, the CSeries 300 is more again for Boeing and Airbus. It's a larger aircraft. So it's a more 737, A320 competition, so no real change in the dynamics.

And again, I think the Delta order was an important one, but it was a bid of 8 years ago and I do not know how much of the \$0.5 billion impairment is related to that order. But between that order and Air Canada's order there is a \$0.5 billion impairment which I think explains a lot about what happened there.

**Q - Derek Spronck** {BIO 17904184 <GO>}

Okay. That makes sense. Thanks very much.

**Operator**

Thank you. Your next question comes from the line of Stephen Trent from Citi. Please go ahead.

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

Hi, good morning guys. Just the two or three for me. First, could I trouble you to repeat what you said earlier about the margins per segment, EBIT margins, I caught Defense at 2.2%, but could I trouble you for Exec and Commercial again?

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

Sure, Steve, good morning. So - this is Fred. So, Commercial is around 12%, 12.3% to be exact. Executive, negative 1.5%, and Defense & Security, you got it right, 2.2%.

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

Great. Thanks so much, Fred. And then in terms of the Executive segment itself, just curious about dynamics for large cabin versus the small and mid cabin stuff, are you sort of, kind of, is it fair to bifurcate this market in terms of pricing trends and what you're seeing in demand, and competition headwinds from those two sides or is it somewhat more uniform than I think?

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

Steve, it's - I think the pricing pressure is across the industry, it's across all niches. And when you do that, and when you see such - so those movements, they tend to blur the lines between segments a little bit. So, a potential buyer of let's say a larger Falcon or Gulfstream, it's not so uncommon now to see that same person interested in and evaluate the Legacy 500, which is a different aircraft, smaller, but cheaper and vice-versa.

So, yeah, there is pricing pressure around. What we have done is to - we could have ramped up our large-cabin, I mean, not large, I mean our larger aircraft, the Legacy 450, 500 aircrafts more than we did. So we are really trying to have some pricing discipline here. The 650 as we already discussed, we have some carryovers from, so that this quarter we had two elements, which were impacted the result. We should be certainly around the mid or the mid to high single-digit, otherwise this can be then our (45:21) non-recurring commercial expense but also purging a little bit of a some carryover of the 650 set from last year, which had aggressive pricing.

So we are I mean, I think we are in a good balance of volume versus margins going ahead and of course, the 300 is the bestseller of its segment about the smaller aircraft. But I think everybody is seeing this - all segments are seeing this pricing pressure and I think until the market really rebounds fundamentally, we have the U.S. today. All the other markets are relatively soft, some are actually - there's very little activities such as, you know, Brazil for example, or even China.

So I don't see a bifurcation, I see an overall trend. And of course just to add a final comment, the preflown market, there's a lot of available relatively new aircraft around there. Some are clearly, I mean, for sale and some - even if they are not officially for sale, but they are always there, also keeping, some drag - in our ability, our industry, ability to raise prices. So the preflown market also plays an important card in this.

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

Okay. That's great. Very helpful, Freddie. And just one last question and I'll let someone else ask you a question. I saw in your release, I was intrigued by the meeting you had with a couple of Middle Eastern ambassadors on Defense products which seems logical given the incredible turmoil in that region of the world at the moment. When you think about longer term, chances to replicate SISFRON or something like that. Would you say broadly speaking that - you're potentially talking to other regions of the world in terms of offering your suite of Defense products?

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

Yes, Steve, this is exactly our willingness, our strategy. As we have built a broader portfolio of our products, but also services integration, we are now able to offer more turnkey solutions than we were in the past. And, of course, as we are able to sell a complete package including, let's say, aircraft radars, C4I system softwares, you name it, integrating third-parties, other OEM equipment into it, this tends to be a, number one, higher revenue numbers. But number two, very importantly higher margin numbers as well.



FINAL

So I think the experience that we have acquired in the SISFRON, in particular, as your question will indeed allow us to be able to play into that segment. And yes, there are other countries that are interested in seeing. We have enabled to with, of course, with the Brazilian Army at their invitation, so some delegation visiting the onsite and seeing what's been done there. It's a great and is a best market than you can have seeing an operating system actually working.

Last year, we actually sold our first integrated system, so I'm not only talking about something which is just an idea. But to your question, we are really focusing and trying to expand that activity and then showcasing that to other countries.

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

Okay. I'll let someone else ask a question. Very helpful, Freddie. Thank you.

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

Thanks, Steve.

**Operator**

Thank you. Your next question comes from the line of Marco Spinar from Neuberger Berman. Please go ahead.

**Q - Marco Antonio Spinar** {BIO 16367505 <GO>}

Hey, thanks for the call. I just wanted to ask a little bit on the trade-ins that you talked about in the fourth quarter call on the Executive business as a driver of poor margins in the fourth quarter. And to what extent that's going on now and kind of what the trade-in strategy was or is and if it's changed at all?

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

No. This quarter I think was relatively normal as far as trade-in, which means no major cost headwinds due to trying to expedite sales of non-Embraer branded aircrafts. So it is where it should be, kind of a neutral contribution to the business facilitating, of course, sales.

So we tend also always to favor trading in our own products. Sometimes we do have to take other manufacturer products. So what we saw last year to your question was I think a little bit a non-recurring event. We should not see another glitch (50:57) of used aircraft or traded-in aircraft being sold to really move the inventory as we did last year.

**Q - Marco Antonio Spinar** {BIO 16367505 <GO>}

And I guess then just to finish up, it just seems very hard to meet the kind of Executive Jet guidance for the year. I mean, I know you're sticking with it, but can you tell us a little bit more about where the improvement really comes in the second half of the year?

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

I think it's a very fair question and here, I'll be glad to share with you our visions. We have a concentration of six fleets (51:38) in the first quarter. As you know, the large - our guidance is from 40 to 50 large cabin (51:47) aircrafts, large for us is Legacy 450, Legacy 500 and Legacy 650. So the vast majority of the remain deliveries will be Legacy 450 then Legacy 500, which have a much more pricing power than the Legacy 650 relatively speaking at this stage.

And on the Phenoms on the light side, 75 to 85 aircraft is our guidance. We are actually today with less - less of a challenge as far as the remaining sales than we were same time of last year. So, number one, we believe the volumes will be there. We are feeling good about our ability to sell and deliver all those airplanes as per the guidance ranges. And number two, there will be a pricing and therefore a margin - sorry not pricing, a margin increase due to mix going forward.

So, if we do something around 80% for the next three quarters in that business, we should land more or less where we said mid- to high-single-digit margins on this. What we need is of something around 80% in average for the next three quarters.

## **Q - Marco Antonio Spinar** {BIO 16367505 <GO>}

Okay. Thank you.

## **Operator**

Thank you. Your next question comes from the line of Bruno Amorim from Santander. Please go ahead.

## **Q - Bruno Amorim** {BIO 17243832 <GO>}

Hi, good morning. I have two questions. The first one is on the trade-ins. I'd like to better understand why is it so different for you guys taking an aircraft from a different manufacturer with regards to the impact of the trade-ins on the margins. Is it because you're not able to sell the aircraft from different manufacturers at market prices?

And my second question is on the impact of low oil price on new orders. You said when answering a previous question that maybe low oil prices should imply a lower level of new orders for new aircrafts. But I remember in previous quarters, you mentioned that not necessarily this environment should imply a relevant impact on the number of new orders for several reasons, the aircraft they had - sorry, the airlines they have other reasons why they could be interested in renewing their fleet. So what is your latest view on that and to what extent do you really believe lower oil price should impact or not the flow of new orders? Thank you very much.

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

Okay. So in trade-ins, the fundamental difference is on our aircrafts. I mean, we have the ability to bring the aircraft in-house and as we have 45 (54:41) certificate of the airplane.

FINAL

We can enhance it. We can introduce options. We can play with the aircrafts and offer a total care package as far as customer support so it's like more an in-house solution.

On somebody else's aircraft, it's fundamentally a late brokerage transaction, so we try to adjust as we acquire it to re-sell it. And obviously, it will depend which price, how much we paid for the aircraft. So, last year, we had a little of debt. We ended up selling used aircrafts at a lower cost than what we actually recognize as a trade-in so that created that non-recurring effect last year. But fundamental difference is actually (55:35) it's actually material, our ability to really do some enhancements around the airplane and holding the inventory, sometimes even investing in revisions or C-checks or whatever has to be done and sometimes blended in customer support packages.

On the lower oil prices, I don't think I may have - I'm not being clear. I don't change my mind. I mean, it's - there are airlines which they have other reasons to obsolescence. We just announced 30 airplanes for Alaska, for Horizon. Delta just supplied new airplanes as well. So, there are procurements which will continue to go on and airplanes will be sold.

What I refer to is that there was a extremely concentrated debt in the last four years or so of orders especially MAX and neos, but also E2s for that matter which they were - they happened in the - with the view that oil would stay around \$100 and \$120 a barrel. So, there was a kind of a golden rush for acquisition of those aircraft.

This urge is clearly down now because we know, number one, the backlogs are full. And number two, oil is - there's no urgency in the short term. So, those airlines which will substitute their airplane in the short term, they're doing that for other reasons such as obsolescence, such as fleet expansion or something like that. But that strong movement exclusively motivated by oil prices, there is a clear slowdown there.

And longer term, I think oil will go up. To which level, nobody knows. And the fundamental, any airplane that burns 15% less fuel than next busy airplane, those fundamental remain. So, they will be the reason for fleet renewals down the road, but just not immediately. So, anybody willing to buy an E2 or a neo or a MAX, they probably can. They are either already in the backlog or they can wait some years down the road for that.

**Q - Bruno Amorim** {BIO 17243832 <GO>}

Very clear. Thank you very much.

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

Thank you.

**Operator**

Thank you. This concludes today's question-and-answer session. That does conclude Embraer's audio conference for today. Thank you very much for your participation. Have a good day.

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