

## Q2 2004 Earnings Call

### Company Participants

- Anna Cecilia Bettencourt, Head of IR
- Mauricio Botelho, CEO

### Other Participants

- Emerson Leite, Analyst
- Gregory Polek, Analyst
- Heidi Wood, Analyst
- Homina Nicaretta, Analyst
- Mary Kirby, Analyst
- Ricardo Fernandez, Analyst
- Richard Haydon, Analyst
- Rob Spingarn, Analyst
- Ron Epstein, Analyst
- Sara Delfim, Analyst
- Steve Trent, Analyst
- Terry Spruce, Analyst
- Unidentified Speaker

### Presentation

#### Operator

Welcome to the audio conference that will review Embraer's year end 2003 results and U.S. GAAP. 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. (Operator Instructions) As a reminder, this conference is being recorded and webcast at [www.Embraer.com](http://www.Embraer.com).

This conference includes forward-looking statements or statements about events or circumstance 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 other markets where the Company is present.

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The words 'believe', 'may', 'will', 'estimate', 'continues', 'anticipates', 'intends', 'expects' and similar words are intended to identify forward-looking statements. Embraer undertakes no obligation to update publicly or revise any forward-looking statements because of new information, future events or other factors. In light of these risks and certainties the forward-looking statements and events are discussed -- forward-looking events and circumstances discussed in this conference call may not occur. The Company's actual results could differ substantially from those anticipated in forward-looking statements.

Participants on today's call are Mr. Mauricio Botelho, Chief Executive Officer; Mr. Antonio Luiz Manso, Chief Financial Officer; and Mr. Marcelo Rodriguez [ph], Controller; and Ms. Anna Cecilia Bettencourt, Head of Investor Relations of Embraer. I would now like to turn the conference over to Mr. Botelho.

### **Mauricio Botelho** {BIO 13386065 <GO>}

Good morning, ladies and gentlemen. It is a pleasure to be again with you. I am Mauricio Botelho and I have here my colleagues to join me in this conference call. We are presenting the Second Quarter results, achievements, and I'll just make the highlights and comments on the general trends of the business and then I'll pass the (inaudible) to Anna Cecilia who will develop the financial issues in this quarter.

I think that we had a very good quarter. From the certification of the Embraer 170 jet in late February this year we started our production and growing the production in a very steady way. And in such a way that we achieved today this quarter the strongest revenue ever in the history of Embraer with -- in this very, very challenging environment that we are (inaudible). I think that all the results that we achieved -- they are showing strength, they are showing good direction and showing that we are following what we have planned.

I'd say that -- the highlights that I would say for this quarter were the 22 new orders added to Embraer's backlog from Finnair, 12 Embraer 170 firm orders; Republic 3 firm orders; (inaudible) 7 ERJ 145 orders. And we have also to celebrate the delivery of the 800 ERJ-145 aircraft for Republic Airlines in Chautauqua which will be operated by Delta. Also in June our Chinese assembly line of ERJ-145 celebrated the first deliveries of 2 aircraft for China.

As a whole I would say that the market is still showing a very good reception for the Embraer 170, different opportunities are spread in the world. I think that the development of the new family progressed as well as the 170 now and the 175 is forecast to be certified in December this year. The Embraer 190 certification campaign progressed; the third aircraft is already in operation, the fourth will be in the next few weeks (inaudible) will be flying, joining the (inaudible) campaign and I think the program is showing that it is a very good program and we expect it may repeat the success of the ERJ-145 family of jets.

I think that at this moment when we look at our business we see that we were able to put together the strength to move ahead as we have done in the past. Time is not easy, but I think that we are facing these challenges in a very sound way; achieving cash, achieving

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backlog, achieving performance and we believe that we are going to follow the trends that we had anticipated. I'll pass the word to Anna Cecilia and then I will be back for the question-and-answer session and I thank you for your attention.

## Anna Cecilia Bettencourt

Thank you, Mauricio. Good morning, everyone. We delivered during the Second Quarter 2004 43 aircraft and we add to 28 in the Second Quarter 2003 and 23 delivered in the last quarter. With the 66 aircraft delivered during the first six months of this year we are on track to meet our target of from 160 jets delivered in 2004. For 2005 we expect to deliver a total of 170 jets. It is important to mention that 3 ERJ-145 deliveries this quarter were counted as operating (inaudible).

Net sales reached 924 million, 62 [ph] percent higher than Second Quarter 2003 net sales and 48% higher than last quarter. In the last 2 quarters gross margin has been impacted by Embraer 170 production (inaudible) and its initial average sales drive through benefits given to our launch customers.

It is important to mention that one year after the first ERJ-145 delivery in 1996 our gross margin was 26.9% and four years after in 2000 our gross margin reached 32%. This increase was mainly due to its learning curve. It increased deliveries and customer sophistication [ph]. In 2001 and 2002 gross margin benefited from the record in deliveries and from the devaluation of the currency increasing our margins to 39% level.

All our business segments reported higher sales this quarter when compared to the Second Quarter 2003. Commercial airline sales increased 73% while sales to the defense market -- defense and corporate market increased 25% and 11% respectively. And sales of customer service increased 68%. Income from operations reached \$123 million, almost 2 times higher than Second Quarter 2003.

When comparing to First Quarter 2004, income from operations decreased mainly due to the \$88.7 million received from our risk sharing partners. Even considering the initial stage of the Embraer 170 production, operating margin reached 33.3% higher than Second Quarter 2003 and the remaining quarters of 2003. Net income reached \$80 million, 17 times higher than last year when it was affected by depreciation of the real [ph].

Accounts receivable were relatively flat at \$471.6 million this quarter of which approximately \$350 million were related to the (inaudible) which the sales financing is still being finalized. Also it is important to mention that as we announced our intention last quarter, we were able to structure our (inaudible) transaction with one of our customers using to fund its first six months (inaudible) as well as aircraft scheduled for delivery up to September 2004. This year we are foreseeing a much more stable accounts receivable position compared to last year.

Inventories is another factor that impacts our working capital needs. Despite the increase in the number of (inaudible) aircraft in our inventories, which in three months has increased from \$138 million to \$147 million at the end of this quarter, our inventories

decreased \$27 million principally due to the increase in EBITDA for Embraer 170. Our total loans increased \$107 million as we are expanding our debt maturity. Also our debt exposure to the real declined from 14% last quarter to 10% this quarter.

Despite the increase in our loans our U.S. dollar debt -- cost declined from 4.25% to 3.6% this quarter and the (inaudible) portion decreased from 14.4% to 13 this quarter. As we said at the end of June, 66% of our debt were long-term compared to 59.4% last quarter. The long-term credit lines are due to mature between 2005 and 2015. The short and the long-term average line is set at 2. -- two years and five months.

Finally due to the stable situation with our accounts receivable, inventories and \$232 million in free cash flow generation, our net cash position increased from \$178 million in the First Quarter 2004 to \$304 million in the Second Quarter 2004, a very liquid position. This free cash flow generation allowed us to distribute to our shareholders a total of \$51.5 million this quarter which represented 64% payout ratio. So for this year we have distributed \$86 million with a payout ratio of 47%.

We ended the quarter with 171 firm orders in backlog from the ERJ-145 aircraft to be delivered and two 724 options. This quarter we added to our ERJ-145 family orderbooks 7 new orders received from TransState an (inaudible) as already mention. The Embraer 170.190 family backlog stands at 273 firm orders with 250 aircraft to be delivered and an additional 300 options. This quarter we added 12 new orders from Finnair and 3 option conversions into firm orders from Republic.

Also late last year Air Canada signed a commercial proposal for 45 Embraer 190 jets with options on an additional 45 which are not included in our backlog. Furthermore, in July Republic confirmed 2 additional options which are going to be added to our September backlog.

Our total firm backlog at the end of the quarter was \$10.5 billion, almost 4 times our last 12 months sales. We already -- as we already mentioned, we expect to deliver 160 jets this year and an additional 170 next year. We are maintaining our delivery guidance for this year and the next week with the breakdown as shown in this last slide of the presentation. Our delivery forecast is essentially sold out for 2004 and approximately 85% sold for 2005. Thank you. Now we will open this conference call for questions and answers.

## Questions And Answers

### Operator

(Operator Instructions) Rob Spingarn, Wachovia Securities.

### Q - Rob Spingarn {BIO 5996882 <GO>}

Anna, could you -- just going back to the EETC with -- I believe it's with Continental -- how many deliveries did that cover year to date and how many does it cover going forward?

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

One moment, Rob.

**Q - Rob Spingarn** {BIO 5996882 <GO>}

Thanks, Mauricio.

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

Very, very pleased to have of your question. Antonio has to look for the proper data.

**Q - Rob Spingarn** {BIO 5996882 <GO>}

Okay. While looking for that, maybe I could just ask you about the tax rate. It came in very favorable again and I'm wondering what we should be looking for going forward?

**A - Anna Cecilia Bettencourt**

Regarding the Continental deliveries, it involved 16 deliveries from January up to September this year.

**Q - Rob Spingarn** {BIO 5996882 <GO>}

Then it concludes?

**A - Anna Cecilia Bettencourt**

No, then we'll have more deliveries from September up till next year. It was concluded -- this transaction was concluded in the 1st of July.

**Q - Rob Spingarn** {BIO 5996882 <GO>}

Okay. So in other words the receivables were lowered by the amount of that -- I think it was \$174 million EETC, something like that?

**A - Anna Cecilia Bettencourt**

Yes.

**Q - Rob Spingarn** {BIO 5996882 <GO>}

So you received cash.

**A - Anna Cecilia Bettencourt**

Yes.

**Q - Rob Spingarn** {BIO 5996882 <GO>}

And it's reflected in the June statement?

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## A - Anna Cecilia Bettencourt

Yes.

## Q - Rob Spingarn {BIO 5996882 <GO>}

Thank you. Then just back to the tax rate. What's a good tax rate going forward?

## A - Anna Cecilia Bettencourt

Normally the effective tax rate is affected by the currency volatility because we have some (inaudible) assets which are counted in our balance sheet in (inaudible). So it affects -- the real appreciation or devaluation in a period, it can affect the effective tax rate. But so far as exchange rate has been more or less relatively stable in this quarter, we've been presenting an average effective tax rate of between 27-29%. But again, it's difficult to forecast how the exchange rate can affect our effective tax rate.

## Q - Rob Spingarn {BIO 5996882 <GO>}

Okay. In other words the financial transaction loss, which I guess marks to market certain assets and liabilities, that's really difficult to forecast as well?

## A - Anna Cecilia Bettencourt

Yes.

## Q - Rob Spingarn {BIO 5996882 <GO>}

Is there any rule of thumb that we should use with a given change in the exchange rate?

## A - Anna Cecilia Bettencourt

It's pretty difficult so far what the market is expecting looking -- by the end of the year the exchange rate should be a range of 3.10 real per dollar.

## Q - Rob Spingarn {BIO 5996882 <GO>}

Okay. Then just on ACS, can you give us some sense of the contribution? I suspect in the early period it will just be from perhaps an R&D perspective, but what you expect the contribution to be for the remainder of '04 and '05 and then thereafter once you go into production?

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

I think that the ACS contract was something of extraordinary importance for us. The contract itself, it is a superb contract. We are going to supply 58 aircraft for the Army and the Navy and this is the first approach for it. This contract will be split in a phase which is system, design and development phase comprising 5 aircraft. We have to -- these aircraft have to be manufactured here and integrated in the U.S., but this will be done by 2007. From that point on we have production contracts moving on and it is forcing us to take about 15 years as it is seen today.

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So what I can say is that it's very common to have this structure in a military contract. First they developed a prototype and then after the prototype is accepted and the system is proved to be okay then the serious production starts. The point is that this opens an enormous opportunity for us in the United States as far as our aircraft was then accepted to be operated and supplied to the U.S. Armed Forces. And this is what makes this contract strategically extremely important. So I think that this is the general view about the contract.

In respect of our participation, I cannot disclose the portions of the contract, but it is a very relevant portion. If you understand that this aircraft, of course, is more complex by itself than a normal regional jet; you can make your own approach about what is the shared compare also considering the product support along the time and to satisfy a need of total (inaudible) ability anywhere in the world. So it is a very good contract and we are very proud of being part of the Lockheed Martin team in this country.

**Q - Rob Spingarn** {BIO 5996882 <GO>}

Mauricio, Lockheed will be contributing all of the electronics?

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

No, there are a lot of other companies such as L3COM, such as Harry's [ph], Rachin [ph] also has a portion. The group is a big group. But the integration and the conception of the system is from Lockheed Martin.

**Q - Rob Spingarn** {BIO 5996882 <GO>}

But I guess what I meant is Embraer is really strictly providing a modified airframe?

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

We will be providing the airframe and the integration will be done in our facility that we are going to have implemented in Jacksonville, Florida around -- the groundbreaking ceremony will take place on the 23rd.

**Q - Rob Spingarn** {BIO 5996882 <GO>}

Okay. And as a final question, could you give us an update on any of the major campaigns or the quantity of large campaigns you have right now in the commercial market? I would say large, anything more than 20 aircraft per campaign?

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

Well, there are about 2 to 3 campaigns in this situation. None of them to be decided in a short-term basis. We do not have the control on the customers' view in deciding about their wishes.

**Q - Rob Spingarn** {BIO 5996882 <GO>}

Thank you, very much.

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

Thank you. Very good to talk to you.

**Operator**

Steve Trent, Smith Barney.

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

Just 1 or 2 quick questions. With respect to the R&D that's booked as operating income, you had mentioned before that you were looking for 40 million in '05, 30 some odd million in '06, and I noticed you did it this quarter. I was wondering, one, if you could give us some indication as to what's going to be the R&D operating income for the second half of this year? Two, you also mentioned some impressive gains in gross and operating margin from the onset of the 145 program to a few years into the 145 program. And I was wondering if you might tell us if you decided did a similar move to book R&D contribution from that program as operating income?

**A - Anna Cecilia Bettencourt**

Answering the second part of your question, at that time the development of the ERJ-145 was (inaudible) in a different manner which we did not receive a cash contribution from our suppliers as in the way that we are receiving (inaudible). They made a large investment on their own facility. But the cash contribution wasn't in the same way that we received with the Embraer 170.

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

Great. Thanks, Anna.

**A - Anna Cecilia Bettencourt**

And regarding the timetable for the research and development, just a moment please. We can give you later because we don't have it here right now on our -- in front of us. I can give you in a call, okay?

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

No problem. Just one quick final question. With respect to what you mentioned about the 3 jets in the quarter that were booked as operating leases, do you anticipate any of the remaining 160 deliveries this year going as operating leases or any of next year's deliveries?

**A - Anna Cecilia Bettencourt**

For this year we anticipate more to be accounted in the same way. Next year so far, no.

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

Very clear. Thanks, guys.

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## Operator

Ron Epstein, Merrill Lynch.

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

Mauricio, just a couple questions. My first question is if you can walk through your outlook on commercial aerospace from the point of view that we're going into a period now -- there's been some negative press on US Airways, Delta has been in the news, United has been in the news. From your point of view what do you see happening in with the civil airlines in North America?

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

The picture is not bright. What we see is we keep seeing a certain portion of the market doing well and this portion regards to the regional airline and the low-cost airlines. The major airlines, they are definitely living with very strong difficulties. It's hard to say or to anticipate what's going to happen, but we have to look at the situation with caution.

One may question, 'but what about the impact if something wrong goes with the major airlines, what's going to happen with the regional airlines?' I think that there will be an impact as well. But the problem is that the regional, even if the major suffers an impact which momentarily can have any influence on the regional, very fast that service will be provided by to another major who will take the responsibility for that market. See what has happened with TWA. We couldn't even (inaudible) a day when the market solution came and the TWA network was assumed by American.

So I think that the picture is not bright, as I said, but I think that the service is there and it is being demanded and it being -- a solution will come no matter if one or other airline will suffer stronger difficulties. When we look at the low-cost airlines I think that they keep doing well. They are expanding their network area, they're penetrating in the market. They are keeping their profitability and I think that they will be a strained in this scenario.

If we came from the U.S. to Europe I think the situation is not that bad. I think that even though the airlines are still struggling with some difficulties the level of difficulty is much, much lighter than they are in the U.S. In Asia on the contrary we see -- you see airlines recovering very fast in terms of traffic and in terms of use. So I think that there is a big issue in the United States which by far is the largest market in the world. But as I said, even though some of those airlines may be getting into stronger difficulties I think that market will respond for that situation and service the demands that exist will be serviced.

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

, Okay. Another question for you again, Mauricio. The win on ACS was a major victory. In terms of the strategic impact that has on Embraer going forward and in particular with other international sales of a similar platform in other NATO countries, can you speak to that?

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

Yes, I just can't speak about that, about my wishes and my positive perception from that. But I really think that the strategic content of this contract is very important. First, in the United States there are areas that we have never supplied anything such as US Coast Guard, the homeland security system which is now -- is receiving a big attention from the administration. And if you look at our products, our products are medium sized intelligence, reconnaissance and surveillance systems and this is very much adequate for those limited operations.

So it opens for sure the fact that we have been accepted as a valued and reliable supplier for the Army and the Navy qualify us to participate in other areas. (inaudible) West is one of the -- it is the largest supplier of military goods for the world. And in this sophisticated arena it is for sure the brightest and the largest supplier and there is a very interesting mechanism in the U.S. to assist this military export sales which is FMS [ph] which is a financing system for military products. And as far as this product has been developed and supplied in the United States by an American group of companies which include Embraer products for sure, I see that foreign markets can be served, could eventually be served from supplies from the U.S. in this same type of product. So I think that opportunities are several and of great magnitude for us.

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

Okay. Thank you, very much.

**Operator**

Heidi Wood, Morgan Stanley.

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

Good morning, very nice quarter. I want to clarify the point on the 3 operating leases if you don't mind. First of all, when do those translate into a sale? And I understand there's some more to occur, but just to make sure I'm square, is that or is that not counted in the 160 and 170 delivery guidance you're giving us currently?

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

Yes, it is considered in the 160 because they were actually deliveries and sold. They were sold, and there is a financial entity who is covering the operation. However, this contract, the customer has a right of walk-away. And that's why it is not accounted as permanent sales at this point. But in terms of the operation, for us, it was a true sale. We sold the aircraft for the customer. We received the cash and it's really add [ph] in here. We had the finish [ph] here backing up the operation totally, and all we have is the possibility of a put in the future. So that's why it's not --.

**A - Anna Cecilia Bettencourt**

The 100% of the value will be recognized in 36 months.

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

Okay. Is that recognized over time or is that a one-off event?

**A - Anna Cecilia Bettencourt**

I'm sorry?

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

No, that's okay, I think I know the answer. When do you expect the Air Canada order to be firmed up? And just again to be clear, are you counting that in your 2005 calculation of being 85% full?

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

No, there will be no deliveries in 2004.

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

No, I mean 2005.

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

2005, yes, we understand it is. And it is accounted for that, but we don't see any problem in the signature of this contract. The other thing is that the customer is preferring to have it -- firmly sign it and announce it after he can solve these internal problems with different entities.

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

Okay.

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

Labor [ph] entities and (inaudible) funds or whatever.

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

And do you think that contract can be firmed up by year-end?

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

Oh, yes, I do. I do believe it is a matter of a very few weeks.

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

Okay. Can you give us an update on where you see margins coming in for the year? You had at one point been guiding 36% margins. Obviously, with what you have done in the first half, that would be a real hockey stick in the second. Where are you coming out for the year?

## A - Anna Cecilia Bettencourt

We are seeing our margins with this new family already adding revenue in the range of 32, 34% over the next few quarters.

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

Great. Mauricio, I want to take a question that Ron asked and ask of you in a slightly different way if you don't mind. If we look at the deliveries that you've done over the last couple of years, it's been very oriented towards the U.S. domestic market. And obviously, with the travails of the U.S. market, it sort of does raise the question as when you look forward at future opportunities for Embraer, do you see yourself as being somebody who potentially benefits from the problems of the U.S. carriers, i.e. as they move towards lower-cost products? Or are you trying to drive the business towards more international exposure, more presence within Asia and Europe; and kind of at that Y in the road, where are you sort of more tilting?

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

Heidi, what we see, when we were talking about the ERJ-145, for sure the U.S. was absolutely the leader in this market. We have success also in Europe, but if you compare that we have sold to Europe something like 180 aircraft, and to the U.S. -- sold, I mean in operation today -- and the U.S. you have 600, you see that there is a huge difference between the 2 markets. U.S. is prepared for that sort of small jet regional operation. It is more difficult in Europe. In Asia it is quite impossible; you have a very limited market for that first because you have what makes the regional airline system to expand, economic decentralization, tourism and these are the two driving factors.

So if you consider Asia you have -- and there is there another burden because you have in very small distances city (inaudible), you have huge demand. Tokyo-Osaka for instance, for 500 miles, typical for a regional operation, it is served by Boeing 747s. So in spite of having the (inaudible) serving both cities, so that is better for a regional airline operation. Furthermore you have limited operation in some areas. The biggest market in that area, for sure it will be China and followed by India.

So in the small jet operation the U.S. is absolutely the leader by far compared with other markets. When we are introducing this new family of aircraft, 70 seater up to 115 seaters, things become slightly different. The U.S. is (inaudible) the leader, but there will be a -- proportionately speaking, there will be further opportunities in Europe and in Asia that you don't see today with the small jet. Necessarily it will come to have better distribution in the market with a new family of aircraft than the distribution that we see in the ERJ-145 family of aircraft.

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

Fantastic, thank you. That was very helpful. And one last question, a small question. Can you give us an update on where you see your year end net cash?

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

Growing.

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

One point though -- I think Antonio Luiz said that net cash might be at the 300 mark, but given that you've already achieved that this Second Quarter, do you see yourself a net user of cash in the second half or could you be even more positive to where you are currently?

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

As I said, we realize the free cash -- the free cash we have now, around the 300, I am absolutely in line with what Antonio Luiz said, we are growing but there is some hundreds to come still.

**A - Anna Cecilia Bettencourt**

What affects more our working capital needs is inventories and accounts receivables. So we are foreseeing our inventories in the range of \$1 billion and our accounts receivables in the range of \$400 to \$500 million -- total accounts receivable. Meaning our (inaudible) to aircraft would be in the range of \$300 million.

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

I'm sorry, the financing would be in the area of about 300 you said?

**A - Anna Cecilia Bettencourt**

Financing aircraft because in accounts receivable we have accounts receivable from the sales, customer service. So looking only at aircraft we foresee in the range of \$300 to \$400 million.

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

Okay, excellent. All right, I'll let somebody else ask questions. Thanks very much.

**Operator**

Richard Haydon, Omega Advisors.

**Q - Richard Haydon** {BIO 1879783 <GO>}

Could you help me better understand how the dividend payout is determined?

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

Okay. Basically what we have is a policy in which we distribute 50% of the dividends that can be considered as cash redeemed [ph]. This means all the receivables that are not considered anything that is not transformed in cash we do not consider it as part of the profit that can be distributed. So the policy that we try to keep ongoing is to distribute 50% of the cash redeemed profit. This is the policy. But at this point -- in Brazilian GAAP,

that's important. Based on Brazilian GAAP because that's what we have to roll our distribution. But this has been -- sometimes has a difference in U.S. GAAP but it is because of the necessary adjustment from one system to the other system.

**Q - Richard Haydon** {BIO 1879783 <GO>}

Thank you.

**Operator**

Gregory Polek, Aviation International News.

**Q - Gregory Polek**

A quick question about the 170. Last I checked Swiss was supposed to be taking some deliveries this month, is that going to happen?

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

No, unfortunately not.

**Q - Gregory Polek**

Do you have an idea when that may?

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

Swiss is living [ph] a very difficult piece and for our frustration and, I assume, for their frustration as well this -- the receiving -- the acceptance of these aircraft by them is being delayed consistently. Every time every target that is fixed, some few months before the date it is postponed again and we do not have a firm date today to define it. As a matter of fact, we did not consider them for next year deliveries.

**Q - Gregory Polek**

What about the 175? What do you think the likelihood is that you'll have a launch customer in time for certification?

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

Maybe soon. What we are looking for is -- the real intent in developing this product, which at a marginal cost to have an alternative to our customers in which they exchange performance by payload. And that is about the same aircraft. So we consider it an alternative just to better fit in our customers' requirements. When a very sound performance is not required and it will make more effect for the customer to have additional payload. And as a matter of fact, I'm confident that very soon we'll have a launch (inaudible) for them.

**Q - Gregory Polek**

Okay. Great. Do you expect a brand-new customer for that or would it be used more as a growth vehicle by an existing customer?

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

We have already had a brand-new customer for that. Remember with (inaudible) airways. They are talking again to come back to the deal, but so I don't know, let us see.

**Q - Gregory Polek**

Okay. I've also heard some talk about you're looking into a small business jet, even smaller than the legacy. Is that a serious project at this point?

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

Not at this point. We are just looking at different alternatives. We're studying new areas. One of the areas is this one, just studying. There is no definition on going ahead with that.

**Q - Gregory Polek**

So that's no more serious than say maybe a 70 seat business jet or something based on the 70 seater?

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

The same way we are studying opportunities, we are studying what has to be done. We are evaluating what would be the necessary investment, what would be the constraints to have the program be successful. We're looking at different alternatives and all the range of corporate jets. That's a natural growth for us.

**Q - Gregory Polek**

And do you have a firm date from the Brazilian government on when they expect to announce the Air Force contract?

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

No, I don't have a firm date. There is no firm date determined, but there are three months probably now that all the process was finalized. The decision will be taken by the president of Brazil. The process is in his hands and it is up to him to decide. I expect -- personally I expect this to happen very soon, but I have expected that in the past as well.

**Q - Gregory Polek**

Thank you, very much, Mauricio.

**Operator**

Steve Trent, Smith Barney.

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

Just two follow-up questions. First of all, congrats. I didn't extend my congrats on the ACS contract, congratulations for that. I was wondering if you could tell me your analysis, as this is a long-term project, what is your position on the potential contract should the Bush administration lose the election this November? And two, with respect to the Middle East and Asian markets I do agree there's a lot of potential out there for regional jets. At this year's airshow, however, the Asian and Middle Eastern carriers were ordering large jets, 77's and A380 super jumbos comparatively versus regionals. And what your sense is to how long it might take for the regional market to pick up steam in Asia and the Middle East?

### **A - Mauricio Botelho** {BIO 13386065 <GO>}

On the first part of your question regarding the U.S. administration event to possible change. I don't think this program can be affected by this because it is -- imagine that this is a joint program from the Navy and the Army to substitute old-fashioned equipment which is not efficient any more in an area of great concern which is surveillance and to increase the effectiveness of ground forces or in the Navy. So I don't see this as a program to be impacted by political change because it is very much at the center of what is looked for by I think any administration which is efficiency and to have a better chance to provide effectiveness for the ground force. So I think that this program is a very firm one.

Second, when I say -- you mentioned the Middle East. Yes, you're right, there is a very difficult area to have a small aircraft operating. The (inaudible) has postponed their views on acquisition of a 70 seater aircraft and there are other plans over there. But you're right, the Middle East is a very uncertain area for medium and small jets. In Asia I think that -- as I said, if I see the ERJ-145 with a bright future in China because they need a regional airline network in force over there, I see also India has a very good prospective for the small jet. The point is that in India they are still with some more difficulties to overcome before they have a regional airline network. And the problem [ph] is huge. And airlines are strongly subsidized by government and this is something that has to be sold because otherwise they will have to keep themselves as a state-owned company for a long time. So I see this development come in a day that will depend more on political and administrative actions to become really a flourishing market. It will take some time. It is uncertain to say how long or define -- have a clear definition on that.

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

That's super. Appreciate the color, Mauricio.

### **Operator**

Mr. Terry Spruce [ph], Airclaim [ph].

### **Q - Terry Spruce**

It's actually a question about the 94 or so aircraft you were going to try and deliver in the second half of the year. Just really want to know what sort of breakdown they're going to be?

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## A - Anna Cecilia Bettencourt

The breakdown between each family for the year, not towards the end of the year, it's 12% -- no, 52% will be related to the ERJ-145, 12% will be legacy and the remaining number percentage will be the Embraer 170/190 family.

## Q - Terry Spruce

Okay, thanks, Anna.

## Operator

Emerson Leite, Credit Suisse First Boston.

## Q - Emerson Leite {BIO 4003528 <GO>}

Mauricio, 3 items for your comment, please. First of all, what's your view on the new jet family that was presented by Bombardier in the (inaudible) airshow? And specifically, do you see an eventual reaction by Airbus and Boeing in regard to their 130 seater as a potential threat not only to Bombardier but also to Embraer if that happens? Second item for your comment is what is the status of deliveries in the contract with US Airways and then in case things deteriorate further for US Airways what would be the outlook for the contract? And the third, if you could comment on your views as for how Embraer is assessing the business jet market at the moment?

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

Very good. Let's go. About the comparative program that was not announced but it was also presented as a perspective to be defined by early next year, I think that our competitor, Bombardier, they are leaving with a very challenging moment. The fact is that the decision that they took about four years in stretching their 50 seat aircraft to make 70 seats and stretching it again to make an 86 seat aircraft allowed them to get earlier than us into the market and allowed them to succeed in the sales of something around 150 to 200 aircraft. But when our aircraft came into the market it was clear and it was transparent that our product is a much better product than theirs in terms of passenger comfort, in terms of performance, in terms of profit potential for the operators. And this led them with a difficult decision to make. If they do nothing they're going to lose market and then they imagine to go ahead with the program, which would comprise the development of 2 aircraft, something like 110 and 130 seat aircraft, and to cost not less than 2 billion U.S. dollars.

But I mention this not less because we are developing 4 aircraft, 2 and 2 because really the others are derivatives -- developer to marginal costs and we will be spending US\$1 billion to develop them. Our development costs are minimum, half of theirs, and their effectiveness is minimum equal to them if not better. So they will spend at least US\$2 billion in this development. Then at the end they will take five years to have this program, established it and first delivery, five years to deliver 2 aircraft (inaudible) imagine 2 aircraft, one with 130 seats which will be just at Boeing's and Airbus' yards. That would be tough. That would be very tough. The competition in that segment will be dramatic. And the 110

seat aircraft which will be in our camp and will be five years firming ourselves in the marketplace.

So in it is quite a challenging decision. Very risky because what they're planning to deliver is an aircraft with differentiated performance which has still to be proved because it's hard to understand how they can provide those performance parameters that they are announcing and so there is another issue to put together; rather than the financial issue, the market issue you have the technological issue. So it is tough -- a very tough decision. And of course, when you mention about Airbus and Boeing, their 136 will be suffering. Tremendous reaction from those company because that will be competing with the Airbus 8319, the Boeing 737, 600, 700, whatever.

To US Airways, we are following US Airways very closely with very, very frequent meetings and discussions, evaluations with them. We are working to together. We are just seeing the picture as a very concerning picture, but we are, together with them, analyzing the prospects. If US Airways comes to an undesirable new Chapter 11 or whatever I think that we'll have to face that situation. But the (inaudible) point is that I believe that no matter what happens with US Airways there is a demand to the service and there will be other airlines to take that responsibility if US Airways is not capable of doing that.

With respect to business jets, I see that the corporate aircraft business, it is a normal growth (inaudible) for us. We decided to enter in this market about three years ago, four years ago when we launched the legacy program. The legacy was a low-risk program for the customer and for ourselves because as a machine it was based on a very reliable and proven machine which is the ERJ-145 aircraft. And what we did is to transform that machine, putting it in conditions to offer the comfort issues that are required on the business jet and some other operational issues. As a result we have entered the market today; I think the best cost and value ratio in the market for this program, for this business. And we are learning a lot about it and that was the purpose, penetrate the market at low-risk and low-cost approach, a way to allow us to learn about the business and its streaks. And I must tell you that we did learn a lot and we think that we are in condition to progress. And we are analyzing the full range of aircraft for possibilities in this business. Since, as mentioned before, the light aircraft, the very light aircraft or the large aircraft because we know that we are getting the strengths and the capabilities to do that. But so far there is no decision, we are just studying and analyzing the situation. That's it.

**Q - Emerson Leite** {BIO 4003528 <GO>}

Thank you.

**Operator**

Carl Weaver, Bear Stearns.

**Q - Sara Delfim** {BIO 1759641 <GO>}

This is Sara Delfim. Good morning. Two quick questions. First, how operating leases will be accounted next quarters? As other operating revenues or equity income? And how much per quarter do you expect in the next 36 months? And the final question, do you see any

possibility of delivering to US Airways through operating leases in a case of the financial situation gets worse?

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

To the second question, I'll again answer you very immediately, no. We'll not appropriate it as operating lease.

**Q - Unidentified Speaker**

And the first one, it's going to be registered as regular revenue but on a monthly basis. It's going to be accounted in another segment report.

**Q - Sara Delfim** {BIO 1759641 <GO>}

But do you have a number of how much it would be?

**Q - Unidentified Speaker**

It's approximately 700 -- 1.4 million for the second (inaudible).

**Q - Sara Delfim** {BIO 1759641 <GO>}

Okay. Thank you.

**Operator**

Ricardo Fernandez, ING Bank.

**Q - Ricardo Fernandez** {BIO 5573550 <GO>}

Two quick questions here. First on pricing for the 145, 170. Doing the math very quickly I just wanted to see if I'm correct -- around 18 million for the 145 and around 25 million for the 170? Hello?

**A - Anna Cecilia Bettencourt**

Normally we do not disclose the average price per type of aircraft. What we can tell you is that conceiving [ph] Embraer 170 and ERJ-145 deliveries average sale price was around \$20.2 million in the quarter including both ERJ-145 and Embraer 170.

**Q - Ricardo Fernandez** {BIO 5573550 <GO>}

Okay. The other question was regarding costs. Obviously metals, raw materials, aluminum have all gone up pretty dramatically in the last couple of quarters, as a matter-of-fact even last quarter. Do you have an automatic cost pass through in the price of those aircraft or do you have to renegotiate it or --? What's the mechanism, do you get squeezed on the margin, how does that work?

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

We have long-term contracts with our suppliers.

### **A - Anna Cecilia Bettencourt**

And we have long-term contracts with our customers and they both from in the same (inaudible) that we have with more power suppliers we have more power customers.

### **Q - Ricardo Fernandez {BIO 5573550 <GO>}**

So it's just a pass through then?

### **A - Anna Cecilia Bettencourt**

Yes.

### **Q - Ricardo Fernandez {BIO 5573550 <GO>}**

Then the other -- finally more on the cost side. Is it possible to get a breakdown on the cost of goods sold -- labor, raw materials and I guess the supplier components? How that compares say two years ago or a year ago to 145 and how that compares today and what it could be going forward? What I'm trying to figure out is what is the increased labor component in building the 170/190 family going forward?

### **A - Mauricio Botelho {BIO 13386065 <GO>}**

I think you can understand that we cannot open (inaudible) information what is the cost of manpower or cost of material for the different sorts of products. But -- this is my reaction. I will leave you here, Anna, to answer a question.

### **A - Anna Cecilia Bettencourt**

Se started (inaudible) an idea, 80% of our costs -- our cost of goods sold are material and the remaining is labor, depreciation, amortization and others.

### **Q - Ricardo Fernandez {BIO 5573550 <GO>}**

Okay. And -- actually I used to get better information in the past, but I guess when you have an ADR it becomes more difficult. The other question, this is really more long-term -- given the various studies in terms of the regional jet market the 170/190, the rule of 110, 170 what have you -- what do you think -- say five years from now, if you had to give a normalized delivery number what do you think the market is looking for in terms of these 50 to 110 seat aircraft? What would be a number and then what do you think your market share would be just to get a feel for the long-term delivery number/revenue number for an Embraer without thinking of new productlines?

### **A - Mauricio Botelho {BIO 13386065 <GO>}**

Our forecast for 20 years is that we see about 8,400 aircraft in this category from 30 to 120 seat aircraft. If we split it in 10 years and 10 years the next 10 years something like 3,700 and the following 10 years 4,700. And despite this we see a substantial market for the 60 to 120 seat segment around 2,500 the next 10 years and 3300 for the following

10 years and we see that a market of 1,100 aircraft for the 30 to 60 seats and 1,400 in the following 10 years. So this is market forecast made on both -- considering macroeconomic aspects and customer approaches and views. So it is a mixture of a process that leads us to these market expectations for our products.

**Q - Ricardo Fernandez** {BIO 5573550 <GO>}

Okay. So that's like 370 aircraft a year more or less. You would expect to get at least 50% of the market or more?

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

We are going -- today in the 30 to 60 seat market niche we have market share in the range of 45%. If we consider the full range from 30 to 120 seats we'll be in the range of 35 to 40%.

**Q - Ricardo Fernandez** {BIO 5573550 <GO>}

Okay. Thank you very much.

**Operator**

Homina Nicaretta [ph], Bloomberg.

**Q - Homina Nicaretta**

I have just one quick question. From your comment on jet airways, can you just be a little bit more specific or how many aircraft we're talking about and why they would be buying the Embraer 175? You said that you had resumed talks, that's it?

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

Yes. On July 2002 we made a couple of announcements during the (inaudible) airshow, Jet Airways and ourselves on the acquisition of -- I think I remember 10 firm orders for the Embraer 175 where they would be the large customer for that. And there would be also about 10 options included in that idea. The fact is that Jet Airways entered into difficulties, financial difficulties and the difficulty is also in the market and they postponed their decisions and we never have a contract signed. And what they say is that Jet Airways is coming back for discussions about that, but we don't know when this is becoming true or becoming a contract.

**Q - Homina Nicaretta**

But they're already in talks with you to resume the contracts or no?

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

Since the very beginning. And this issue talk all the time.

**Q - Homina Nicaretta**

Okay, all right. Thank you.

## Operator

Ron Epstein, Merrill Lynch.

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

Just a quick follow-up question regarding the Embraer 170. What are the current cycle times on a 170?

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

Still growing, still growing. Today we are taking about seven months.

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

What's the goal, what do you guys want to get that down to?

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

When we reach the four months.

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

Over what time frame would you like to get there?

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

Mid next year.

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

Really? Okay. That's it. Thanks.

## Operator

Mary Kirby, Air transport intelligence.

**Q - Mary Kirby** {BIO 6249024 <GO>}

Mauricio, I apologize for returning again to this subject, but I wanted to ask you in regards to US Airways how many of the 170's have already been delivered to US Airways? And should the carrier have to take a second trip through bankruptcy and perhaps halt deliveries of 170's, where would that put your delivery schedule for 2005?

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

That is our favorite question. In respect to US Airways deliveries this year, we have deliveries at this point, 12 aircraft.

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**Q - Mary Kirby {BIO 6249024 <GO>}**

Okay.

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

There would be maybe 36 in total and this is a situation for this year. If they come into a new Chapter 11 situation it's hard to say at this moment what -- to predict what will happen. But if it's not feasible to make or to build up a financial structure for that deal it will be impossible to keep delivery. But I emphasize that. I think that no matter what happened with US Airways, the demand is there and I think that the service will keep being provided.

Mary Kirby; And just so I am clear, you said it's a total of 36 deliveries already?

No, no, not already. For the year.

**Q - Mary Kirby {BIO 6249024 <GO>}**

There will be 36 this year, okay. Great, thank you very much.

**Operator**

Thank you. And this concludes today's question-and-answer session. I would like to invite Mr. Botelho to proceed with his closing statements.

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

Very well. Thank you, very much for your attention. I think that I emphasized that I see the prospects as good. The environment is not calm, on the contrary it is a challenging environment. But I think that we have been able to create the strength that will allow us to cross this scenario in a very good way, a solid way, a healthy way and with the cash that will allow us to face these challenges with the products that allow us to serve our customers adequately with the service behind the product that allows them to keep being the profit maker for our customers and going on and moving ahead on our development plans.

By the way, today we delivered a proposal to the Portuguese maintenance repair and overhaul facility in Portugal and which I think will represent strategically a good factor for our operation. If we succeed in becoming also a European company as well as we are today a solid American company and with the headquarters in Brazil. I think that all of this makes us to progress in a world network being close to our customers in China, in Europe, in the U.S., in Brazil and elsewhere. And with our objectives of keeping our customers properly served and growing as far as we are also growing. Thank you, very much for your attention and hope to see you soon in many other occasions.

**A - Anna Cecilia Bettencourt**

Thank you. And we are available for the ones that still have some questions and you can call us, we'll be available for the whole day to answer your questions. Thank you. Bye-bye.

## Operator

Thank you. And that does conclude Embraer's year end 2003 results in U.S. GAAP audio conference for today. Thank you, very much for your participation. Have a good day and thank you for using Conference Call du [ph] Brazil. You may now disconnect your lines.

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