

Q2 2013 Earnings Call

Company Participants

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

Other Participants

- Eduardo Couto, Analyst
- Joe Nadol, Analyst
- Myles Walton, Analyst
- Noah Poponak, Analyst
- Peter Skibitski, Analyst
- Ron Epstein, Analyst
- Turan Quettawala, Analyst
- Unidentified Participant, Analyst

Presentation

Operator

Good morning, ladies and gentlemen, and welcome to the audio conference call that will review Embraer's Second Quarter 2013 results. Thank you for standing by. (Operator Instructions). As a reminder, this conference call is being recorded and Webcasted at 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 and uncertainties and assumptions, including, among others, 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 a forward-looking statement.

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 uncertainties, the forward-looking events and circumstances discussed on this conference call might not occur. The Company's actual results could differ substantially from those anticipated in the forward-looking statements.

Participants on today's conference call are Mr. Frederico Curado, President and CEO; Mr. Jose Filippo, Chief Financial Officer and IRO; Ms. Elaine Funo, Director Tax Accounting; Andre Gualda, Controller; and Mr. Luciano Froes, Director of Investor Relations.

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

Frederico Curado {BIO 2004589 <GO>}

Thank you. Good morning, all.

This quarter came very much in line with our planning as far as the operation of the Company. As everybody is aware, we did have a strong devaluation of Brazil's currency during this quarter. And that, according to IFRS, creates the need for a provision on our income tax related to our non-monetary assets, which -- it's a noncash event. That turned to all of our operating profit into a net loss in the quarter. And Filippo here, our CFO, will explain, of course, this effect in more details during our conference.

So I'll ask Filippo to go through our presentation. And, later on, I'll be back with the rest of the team for Q&A. Thank you.

Jose Filippo {BIO 1726218 <GO>}

We'll go through the presentation. And then we'll open for the questions.

So, starting page three with the corporate highlights, we had this quarter one important milestone in the Company's history. It was the launch of the E2 E-Jet program following the early this year announcements of contracting major suppliers. So we were able to launch during the Paris Air Show in June. And I'll go to some of the highlights of the commercial activity of this aircraft in the commercial page.

So here is this important milestone then, the launch, followed by an important upgrade that we received from Standard & Poor's, a credit rating upgrading from BBB; to BBB with a highlight for the recent commercial orders, the business diversification. And also operational efficiency. This is important recognition with the neutral trend.

Important also for corporate highlights, Embraer's recent recognition from major magazines and institutions. We were awarded by the -- Company of the Year from Brazilian "Exame" magazine, as well as maintaining our position in the -- one of the best companies to work in Latin America from the Great Place to Work, as well as award from the Brazilian National Industry Conference, the C&I National Innovation Award.

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Next page in terms of highlights of commercial aviation business. We delivered in the quarter 22 aircrafts, an increasing quantity compared to the First Quarter. We have currently, year to date, 39 aircrafts delivered.

Important also, orders for the current generation of the E-Jet. The United Airlines order of 30 aircrafts with an option for an additional 40 -- also, we had the Conviasa of Venezuela order for seven, together with SkyWest, which signed a 40 E175 jets plus 60 reconfirmables and also options for additional 100. This is expected to be delivered in the following three years. And it's good activity for the first -- the current generation of the E-Jet. It's finalizing to mention that we had disclosed firm orders for five E-Jets from Air Costa in India and Japan Airlines.

Regarding the E2 program, which I mentioned of the launch, we had the launch with launch orders of 365 aircrafts, with 100 firm orders from SkyWest plus option of 100 and, also, 50 firm orders from ILFC, which, at the time of the launch, we couldn't disclose and couldn't confirm actually. They were LOIs. Now we're able -- we are able to confirm those orders with 50-plus options, together with the total orders for this product, LOIs for another 65 undisclosed customers.

Moving to next page in the executive jets activity, the highlights. The delivery of 29 aircrafts in the quarter -- good deliveries, an increase from the First Quarter, more in the light jets, with a market, as Fred mentioned with still some challenges.

Important, as well, with the NetJets receiving the first Phenom 300 entitled the Signature Series, which is one major customer, a potential contract for 125 aircrafts.

Also, the confirmation of quality product recognition from Best of the Best by Robb Report for Phenom 100 and 300 for the third consecutive year. Important for this business.

To finalize the highlights for executive jets with the important milestones for this business, from the delivery of the Phenom number 400 jet and also the first delivery of the Phenom 300 sold -- actually sale of the Phenom 300 to China.

Regarding manufacturing, the Melbourne facility received the FAA certification for the Phenom 300. And the ongoing certification campaign for the Legacy 500 -- we've completed 45% of the test campaign, now with 450 hours flight of the three prototypes of this equipment.

And, finalizing, the important information of maturity of a program, the Lineage 1000 reached 10,000 hours flown.

With that, we finalize the highlights of the executive jets. And we turn to the next page on defense and security. Another important contract announcement with the Brazilian Air Force, the contract for logistic support and service for the Super Tucano aircrafts.

Also, following recent MOU announcement during the Paris Air Show with Boeing, now we're able to disclose this sign of the partnership with Boeing to sell the KC-390 in specific markets.

Regarding the Strategic Communications Satellite program, we continue advances in selection of major suppliers.

For the Sisfron project, we're also advancing well with special selection. And we were able to complete part of this process during the Second Quarter.

Moving to next page, starting to the quarter activity, in terms of aircraft deliveries. We have in page seven the commercial jet deliveries and executive jet deliveries split by category. So, we had 51 deliveries in the Second Quarter. It's now accumulated 80 aircrafts within commercial and executive business in the year-- this expectation that we increase this amount of deliveries during the second half. And we are maintaining the guidance towards the low end of the range for executive jets, 25 to 30 large jets, 80 to 90 light jets. And commercial jets, 90 to 95 deliveries in the year.

Next page, page 8, regarding backlog. We recently announced the amount for the second half -- Second Quarter in the end of June, a total of \$17.1 billion of backlog, a strong increase of 29% compared to the First Quarter. This reflects orders primarily in the commercial business unit. And we got back to levels of the Third Quarter of 2009. And it's good to recall that this does not include. So far, the 50 E2 orders that we recently confirmed from ILFC.

Next page, page 9, regarding revenues by segment. A total of \$1.6 billion in the Second Quarter. We have accumulated \$2.6 billion year to date. We're increasing revenues from the First Quarter in all of the business segments. We expect to continue to grow for the second half of the year. It's good to recall here that the defense and security, although it had increased, has half of its revenues denominated in reais, which had the impact of the dollar devaluation. But, despite this fact, it's still growing, getting to \$309 million in the second half -- Second Quarter, a cumulated of \$551 million in the first half.

On the next page, page 10, the consolidation of the net revenues in dollar terms and real terms. Total in reais here -- the new information of BRL5.4 billion. So we are at this point maintaining our guidance range for the year, between \$5.9 billion and \$6.4 billion range.

Next page, SG&A expenses in dollar and reais. In terms of G&A, we show stable expenses compared to the First Quarter. This reflects our focus on cost control and maintaining the monitoring of these expenses. So we're confident we can keep this level throughout the year. We show an increase in selling expenses, primarily as a consequence of the level of commercial activity in the first half -- in the Second Quarter, both in commercial and executive activities.

Going forward to page 12, income from operations. We had operating profit of \$135 million in the quarter with a margin of 8.7%. Accumulated margin for the year is 6.6% and \$175 million in operating profit. We had this quarter, the Second Quarter, an increase from

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the First Quarter in the direction of the guidance range, which we are maintaining at this time.

In addition to the SG&A expenses, we had an increase in the research expenses, mainly related to the final stages of the E2 program launch. When we compare to the Second Quarter of 2012, it is important to recall that it has here the impact in 2012 of cancellation fees, which didn't occur this year. So that explains part of the reduction that we had in terms of the Second Quarter of last year.

So, again, we are maintaining the guidance for the year, which is for operating result -- a range from \$530 million to \$610 million and operating margin from 9% to 95% (sic; see slide 12).

Page 13, EBITDA. We had the total of \$204 million in Second Quarter, \$304 million accumulated in the year, with a margin of 13.1% in the Second Quarter, a cumulated of 11.5% year to date. So the target -- the guidance for the year in the range of \$770 million to \$900 million and an EBITDA margin between 13% to 14%.

In page 14 regarding net income, we had a net loss of \$5 million in the Second Quarter, accumulated profit of \$25 million in the year. And, as we did experience before in previous situations where the dollar gets stronger against the real -- because of the recognition of this in the economics, the balance sheet, we had the noncash impact, which generated a deferred tax effect which led to this number. If we would do in a pro forma basis just an exercise without this effect, we should have reported \$92 million of profit in the second half -- sorry -- Second Quarter of the year.

In page 15, inventories, we had \$2.5 billion in the end of the Second Quarter of the year. Inventory levels stable compared to the First Quarter and compatible with the planned deliveries that we have in the second half. We are in line, then, with the First Quarter of this year.

Page 16, free cash flow. Total free cash flow of \$2 million in the Second Quarter. We saw an increase in the operating cash generation when compared to 2012 and to the First Quarter, as well, which supported the Company's investment strategy, which was in terms of CapEx. We are maintaining -- we had -- mainly, the increase was related to the Evora plant. This was planned. There's an increase in the expenses this quarter. This is the seasonal effect that we have for the year. So we had a little bit more of CapEx this quarter that is not going to happen throughout the remaining of the year.

And regarding the development programs, we continue to invest; mainly, here, in fact, the Legacy 500/450 program. We expect to see going forward in the second half of the year a positive cash generation reflecting the nature of the business.

In page 17, investments, we had a total amount of \$297 million in the first half. Still projecting the guidance of \$580 million for the full year.

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So, as I mentioned before, we had a concentration in CapEx in the first half, which is reflected in this year-to-date figure. We don't expect to see the same amount for the second half in terms of CapEx. So we're still keeping the guidance given, the \$180 million for the full year.

So the outlook for the year then. Total investment of \$550 million (sic; see slide 17) is what we are expecting -- \$580 million.

Page 18, regarding our capital structure. We had an improvement in the debt profile in this quarter. As you can see, the increase in the long-term portion of the debt, now 94%, compared to 85% in the previous quarter and, also, an increase of the average maturity of the debt from 5.1 years to 5.4 years.

In the net cash position, we had \$51 million (sic; see Press Release "\$58m") of net cash in the end of June, already considering the \$30 million paid as interest in shareholders' equity made in the Second Quarter. So the total debt in the end of the Second Quarter was \$2.2 billion. And the total cash \$2.3 billion in these numbers.

Okay, with that, we finalize the presentation. And we open now for questions. Thank you.

Questions And Answers

Operator

(Operator Instructions). Joe Nadol, JPMorgan.

Q - Joe Nadol {BIO 3056499 <GO>}

My first question is just on the income statement. The other operating expense line -- I understand that you had liquidated damages last year that offset expense. You have an \$18; or \$19-million expense each quarter so far this year. What is the run rate there without items?

A - Jose Filippo {BIO 1726218 <GO>}

Joe, what we have here -- of course, you got the comparison to the previous year -- that we had a positive effect last year. What we have mainly here was the discontinuing of some engineering projects and also some adjustments in the impairment of used aircraft. Basically, we understand that, this year, what we have is an expected, normal level of other expenses here. Basically, there's two items on this line.

Q - Joe Nadol {BIO 3056499 <GO>}

So, in the First Quarter, you had a provision, I think, of \$9 million or \$10 million in that line item. So my expectation was that the expense would come down quite a bit because of that provision going away. Is that not going to be the case going forward?

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A - Jose Filippo {BIO 1726218 <GO>}

No. That provision that we had was related to labor disputes. So it was only -- it was not expected to see any of this going forward.

Q - Joe Nadol {BIO 3056499 <GO>}

Right. No. I understand that. I'm just trying to understand the normal level of that line because you had the provision in the First Quarter. It went away. But the expense did not go down. So is the normal level \$10 million or \$20 million per quarter?

A - Luciano Froes {BIO 17907241 <GO>}

Joe, this is Luciano. If I may add here -- also, in the First Quarter, you had still, back to Filippo's point, as well, a higher level of cancellation fees, roughly around \$6 million or so of more cancellation fees. So, again, some of that delta of the provision is taken away by that lower cancellation in the Second Quarter, number one.

Number two, going forward, this is an expense line. So, typically, you will see in that low, double-digit range -- mid-teens range, let's say for expenses going forward. So, for modeling purposes, that's what I would say you should be.

Q - Joe Nadol {BIO 3056499 <GO>}

Okay. That's helpful.

Then second question. Any update on the corporate jet business on demand in general?

And then, also, on the certification process for the Legacy 500. How is that going?

A - Frederico Curado {BIO 2004589 <GO>}

Sure, Joe. This is Fred. On the certification, we are about half of the campaign through. So we feel very comfortable about our target of entering to service by mid next year of the Legacy 500 and, one year after that, the 450, which we are already in assembly, assembling the first prototype. So we're on track. No show-stopper. Of course, we learned a lot with all these fly-by-wire problems, which made us, of course, delay this program a year. So now we feel much more comfortable about where we are. And. So far, the campaign is going well. The airplane is flying well. The aerodynamic configuration is pretty much confirmed. And we are optimistic about the final results of not only certification but the success of this product in the market. It will be, in our point of view, another champion, if you will.

As far as the market, we see -- on the low end, in the Phenom category, it's been same story over. It's a very fierce, disputed market. We are doing relatively well there. We feel comfortable about meeting our guidance numbers there. We see some softening on the upper range, on the Legacy 650 market, in this higher-end, business jet market. So we also have challenges there.

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So, at this stage, I would say that we are probably going more towards the lower end of our guidance than the higher end but still confident that we can meet our numbers. It's important to say that, if we compare where we are vis-a-vis last year, we are actually a little bit better than we were last year, although we do have challenges to meet our numbers. And we're working hard to do that.

Q - Joe Nadol {BIO 3056499 <GO>}

Fred, just on the softening you're seeing in the 650 category, is that -- ? Do you think that's competitive because there's new aircrafts coming into the market, or do you think that is just the market overall that's getting weaker?

A - Frederico Curado {BIO 2004589 <GO>}

Good question. I think it's -- it may be preliminary. But we see a market softening, not competitors. But it's a bit early to tell. But some signs of some -- I'm not talking about, of course, let's say, the Gulfstream 650 (inaudible). That's very resilient. But the super-midsized segment, large cabin -- in our point of view, it's kind of early symptoms of maybe some softening altogether.

Q - Joe Nadol {BIO 3056499 <GO>}

And, geographically, is that outside of the US mostly?

A - Frederico Curado {BIO 2004589 <GO>}

I would not know, Joe. We can -- again, with our business jet guys later.

Q - Joe Nadol {BIO 3056499 <GO>}

All right. Thank you.

Operator

Peter Skibitski, Drexel Hamilton.

Q - Peter Skibitski {BIO 6760095 <GO>}

I was just wondering. On the spike in research this quarter, you mentioned that was sort of due to the E2 introduction or launch. I just wanted -- I know you kept research -- the guidance intact for the year at \$100 million. But shouldn't we expect the research line to decline meaningfully now that the E2 -- ? I'm assuming E2 expenses will now be capitalized per IFRS.

A - Jose Filippo {BIO 1726218 <GO>}

You are correct. The expenses of the E2 tend to be capitalized. But they were not that high. So it was just like starting -- some of the starting expenses. So as they increase now, it's going to be capitalized. So it's not going to be something that we're already expensing too much. It's going to be changing the line in terms of being capitalized. So it doesn't impact the projection because of this effect.

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Q - Peter Skibitski {BIO 6760095 <GO>}

I see. I understand. Okay.

So, in terms of the margin ramp the rest of the year, should we assume margin rate is -- margin expands sequentially in the Third Quarter. And then we get another large spike in the Fourth Quarter? Is that kind of the profile that you're anticipating?

A - Luciano Froes {BIO 17907241 <GO>}

I would say, roughly speaking, of course, probably going to be more backend loaded; so, Q4 particularly. We don't see margin suppression in Q3 necessarily but, again, the spike trending more towards the back end of the year, really, in Q4.

Q - Peter Skibitski {BIO 6760095 <GO>}

Understood. Okay. Thanks.

And, I guess, maybe the last one. Given the commercial order flow in the quarter -- I know you kept the guidance for this year in terms of commercial deliveries intact. Has Puerto Rico -- ? Have you set your delivery rates for commercial yet for 2014? Do you have a view of the profile there? And maybe 2015 as well. Is 2015 sold out at this point? Can you give us some color on that?

A - Frederico Curado {BIO 2004589 <GO>}

The best vision we have at this stage is a stable production rate for the next few years. 2015, of course, is a little bit out. So there may be some upside there. We still have like 18 months to sell aircraft which can be deliverable in 2015. So talking about more 2014. I think most likely scenario is like a stable production rate, a bit different mix, of course, because there will be more contents of 175s rather than 190s due to these campaigns in the United States. That's the best we can see now.

Q - Peter Skibitski {BIO 6760095 <GO>}

Okay. Thanks very much.

Operator

Turan Quettawala, Scotia Bank.

Q - Turan Quettawala {BIO 6362141 <GO>}

So, I guess my first question was on the US Super Tucano order here in the US. Is that helping you with sales campaigns in other countries? And when can we see maybe some more traction there on that product?

A - Frederico Curado {BIO 2004589 <GO>}

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We expect so. Of course, the cycles in the defense business are pretty long. And, of course, we are still also at the very early stage in the LAS. So we will not see aircraft actually being physically built in Jacksonville until another six to eight months. I think, as we deliver aircraft to the US Air Force and, of course, the aircraft go into service, then our expectation, yes, this seal of credibility on the product will help us out. It's somewhat subjective. We don't see like a short-term, immediate reaction. But I think it's a very strong endorsement for the program in the mid and long run.

Q - Turan Quettawala {BIO 6362141 <GO>}

Great.

And, if I could just ask one more, Fred, on the numbers here. You talked about the stable production rate next year, in 2014. And you also said, obviously, that there are going to be more 170s. And, obviously, a lot of those are from the US campaign here. Does that mean that margins are going to have a bit of a tough time next year, just based on all those different things?

A - Frederico Curado {BIO 2004589 <GO>}

Well, on the pricing side, obviously, we will have -- we have pressure coming from, of course, a smaller aircraft. So the top line is smaller -- will be smaller on each unit. And, as we all know, large campaigns -- they put pressure on pricing. And, on the cost side, we are working very hard, of course, to maintain our margins. And, obviously, some tailwinds are important, such as the currency devaluation in Brazil. So a bit early to talk about margins. But, on the pricing side, for sure, it's going to be a challenge because of the nature of the mix of the aircraft.

Q - Turan Quettawala {BIO 6362141 <GO>}

Great. Thank you, very much.

Operator

Noah Poponak, Goldman Sachs.

Q - Noah Poponak {BIO 16071528 <GO>}

Fred, I wanted to go back to the business jet market. I know you were already asked about it. But hoping to get a little bit more color. In the small or the light end of things, I mean, your main competitor has taken production down 20% or 25% from where they basically started this year. And you're essentially not changing. It's a pretty big variance. Do you feel like you're taking share back, or is the market just so volatile that it's almost random? Or is it something else?

A - Frederico Curado {BIO 2004589 <GO>}

I think, definitely, we are taking some share. Let's keep in mind that this year is probably the first year where we do not have Beechcraft delivering aircraft in that segment. I think it's fair to say that we are probably taking most of that, let's say, empty space. We have

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delivered 31 Phenoms in the first half. And our guidance is between 80 and 90. So, yes, it's a little bit below 40%. We have a very -- we will have a very busy Fourth Quarter. And, again, last year, we were in -- the outlook for the year was even more challenging than it is this year. So I'm not underestimating the challenges. But we still believe and strongly believe that it's doable; again, more, maybe, probably towards the lower end of the guidance. And the fact is the Phenom 300 is really the best in class. And it's been a great success. It is the aircraft which is leading the sales in the segment with -- that's taking most of the market share in the segment. So I think it's very much due to the quality of Phenom 300, the 100 as well. But it's a smaller market demand. So 300 is really the driver here.

Q - Noah Poponak {BIO 16071528 <GO>}

Okay.

And, then, on your larger aircraft or the super mid, I know you were just asked how -- which geographies you're seeing a little bit more softness in. And you couldn't -- you said it's sort of hard to tell. But what makes you say you are seeing that? Is it just a quarter or two of softness on your aircraft specifically? Or are you looking at market-wide pricing activity or inventory levels? What drives you to say you're seeing some softness there?

A - Frederico Curado {BIO 2004589 <GO>}

At least on our side, we saw a stronger demand last year on the -- for example, on China than we were seeing this year. The US is still -- the level of activity in the particular case of the US is more us than maybe the market. So we have to capture a little bit more market share in the United States. That's -- we are probably underperforming compared to competitors and compared to ourselves in other regions.

But there are some reports that, of course, we follow, specialized people who are tracking the markets. And, again, I do not have the specifics here with me. But those reports -- they suggest that there is some softening there.

Talking more broadly, Noah, if you look at the control panel, everything looks good.

There are some clouds ahead in the worldwide economic horizon we think. And we see that. So the question is how this turbulence will -- how far it is and where we are. It's going to happen or not.

So the softening of China -- Brazil is slowing down, for sure. Europe is stabilizing. So I think there is an overall macroeconomic, I'll say, concern or, at least, awareness that there may be some bumps ahead. And the executive jet segment is very, very sensitive to that. So perception there creates an immediate reaction.

But, having said all that, we have a challenge there. We have delivered ten airplanes out of our guidance of 25 to 30. That's where it lies. Our major challenge is to find another 15 aircraft to be delivered, being, again, Fourth Quarter with high activity. And, this day, we still believe it's doable.

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Q - Noah Poponak {BIO 16071528 <GO>}

Okay. I appreciate the market color. Thanks.

Operator

Myles Walton, Deutsche Bank.

Q - Myles Walton {BIO 6802513 <GO>}

Hey, Fred, at a high level, can you talk more about the defense environment, particularly in Latin America and particularly on some of the larger contracts that are relevant to you? Is there a slowdown in contracting activity? Is there any type of pullback from some of the larger initiatives that they've started with respect to Sisfron and Sisgaaz?

And, also on Sisgaaz and the FX program, could you give us a timeline of what you see today?

A - Frederico Curado {BIO 2004589 <GO>}

Sure, Myles. We have accumulated a strong backlog. So we have a strong execution challenge in our programs. Your question is more towards -- more the new programs. I think it's undeniable that Brazil has now some budget challenges as a country. You may or may not have read about some recent cuts on 2013's budget. And it would be naive to imagine that those cuts and whatever comes for 2014 will not affect the defense budget.

So we feel on one side comfortable that the existing programs will be capped. And it will be maintained at their present course. And, of course, we have this strong execution challenge.

I think it's less evident what's going to happen to the new, large, defense contracts in Brazil. So (inaudible) -- of course, it's a necessity. It's also a large dollar amount, another pressure on the budget.

So, at this stage, as I said, it's hard to predict whether or not that's going to happen. But I think it's less likely than it was a few months ago when there was still some positive outlook for the Brazilian economy.

FX? The FX too. Well, it falls in the same basket. But it's hard to -- maybe it's a more -- it can be different because there is an operational need for the Brazilian Air Force. They just have to -- sometime in the future, they have to renew their fighter fleet, which is aging. So I'm not sure the FX can be only analyzed through this spectrum of budget but also, strategically, for Brazil's defense. So maybe that's the best vision I can give you at this stage, Myles.

Q - Myles Walton {BIO 6802513 <GO>}

Okay.

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And, then, one quick one. I think NetJets was a big contributor this year to differentiating your business jet deliveries maybe versus the competition. As you look to next year, is that buyer's profile deliveries a headwind, a tailwind, or neutral?

A - Frederico Curado {BIO 2004589 <GO>}

No. I don't think NetJets as far as quantities has been that much relevant this year. Next year, I think we'll have probably -- (inaudible) later. But, as far as I remember, I think we have more deliveries next year than this year for NetJets.

Q - Myles Walton {BIO 6802513 <GO>}

Okay. Great. Thanks again.

Operator

Ron Epstein, Merrill Lynch.

Q - Ron Epstein {BIO 1868102 <GO>}

Just to follow up on, maybe, Myles' question in a broader sense, given all the recent -- I'll call it social unrest in Brazil, have you seen any impact at all in terms of your labor force or impact on the business, maybe just broadly speaking?

A - Frederico Curado {BIO 2004589 <GO>}

Internally? No, not at all. The protests in Brazil -- they were against, let's say, the status quo of overall social issues, such as healthcare, such as transportation, security in the large cities, urban transportation. And it's more like towards criticizing politicians and political parties and, I'd say, the major institutions.

Companies, in general -- they were not affected by that. And, in particular, Embraer -- we felt absolutely no effect in that regard.

Q - Ron Epstein {BIO 1868102 <GO>}

Okay.

Then, maybe like moving back to aerospace stuff now, when we think about now and the rest of the year, how are the campaigns going? I think everybody knows that there's an active one with Eagle right now. But what else is going on around the world when we think about campaigns for either the updated, current generation of 170s and 190s and, then, the E2 family?

A - Frederico Curado {BIO 2004589 <GO>}

Ron, as you know, there was a strong concentration of orders announced in Paris, something around 1,000 or 1,100 aircraft -- something of that order of magnitude. Most of those airplanes were narrow-body and regional aircraft. So there is a natural hangover of

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the post-Paris. So I don't think we should expect major orders announced by anybody in the very short term.

US is probably the brightest prospect for the industry at this stage. The profit of the airlines there for this year is projected around \$4.5 billion. So the clear consolidation -- positive consolidation outcome in the industry, relaxation of its (inaudible) clause, of course, bringing opportunities for us -- we just are in the first wave of orders for the renewal of the regional fleet.

And you talk about Europe. (inaudible) is giving the network carriers a very hard time, as you know. So that's a tough environment for the network carriers for the -- I'd say the flag carriers. They're just the classic ones.

We are, on our side, seeing some opportunities on the eastern part of Europe. The recent certification in Russia for the 190/195 opens up possibilities there for the region. And, in that region, I think we have some like -- I think, like, eight customers or maybe seven or nine but around eight customers. So we have some expansion there.

Middle East? Some activity brewing up. It's been quiet for a while. Some nice resumption of discussions.

Africa? Kind of stable. But we -- maybe just to mention one example, we are initiating a, let's say, business model tryout with a couple of 190s in Royal Air Maroc, which the short-term lease from one of our lessors, Jetscape -- if that -- it's almost like, as I said, a tryout of a business model. So that hopefully opens up a regional feeding system -- (inaudible). A regional feeding system is something which can bring value to African airlines. Of course, if that proves to be correct, it does not mean that Embraer sees everything. We're just, let's say, the guinea pig in support in that initiative. Hopefully, that will play in our favor in the future.

India? Air Costa, as we mentioned.

China? Some discussions about existing but also about E2 opportunities; I would say nothing short term.

And Brazil? Losing momentum. So we have a backlog in Brazil. And this backlog -- we feel very comfortable about executing that backlog with Azul and Trip. But there is a clear slowdown in the domestic market here.

So I tried to walk you through the whole world. This is where we are.

So, in the end, we are seeing a strong market, I think, \$12 billion or \$13 billion or something like that, is the IATA profit forecast for the year, which is a stronger industry than it was, certainly, a few years ago. So we are cautiously feeling good about, let's say, the general state of the airline industry.

FINAL

Q - Ron Epstein {BIO 1868102 <GO>}

And then maybe just one last question, jumping back to defense. Can you give us an update on how the KC-390 program is doing, where we are. And where we have to go?

A - Frederico Curado {BIO 2004589 <GO>}

Sure. We have -- we are in the middle of the massive delivery of drawings -- release of drawings from engineering to production. So we are -- I do not have the specific numbers. But we are pretty much on schedule as far as the production of drawings. It's important to say that the way we have set up the program -- we are releasing, let's say, the most complicated parts and talking about, for example, spars and ribs and ribs also for both wings and fuselages. So it's going pretty much as planned.

We probably will start using the prototype, I would say, around early next year for -- they maybe will start even maybe later this year or early next year. And everything tells us that flights -- the first flight is doable before the yearend of 2014, before -- 18 months from now, approximately.

So, as far as the cash flow, the government is also on schedule. So we have no delays in payments. And, as I told Myles, we expect the existing programs to be protected by any business -- I mean by any budget restrictions that might affect the defense business in Brazil. So I think, if there are some constraints, they'd be more towards new programs rather than to any existing programs.

Q - Ron Epstein {BIO 1868102 <GO>}

Great. Super. Thank you.

Operator

Stephen Trent, Citi.

Q - Unidentified Participant

This is Kevin (inaudible) on behalf of Steve Trent.

Just a couple questions. Now, when should we think of a firm order as a firm order -- when the contract is signed and the customer proves they have the financing and they put down a deposit? We were just a little bit confused about some news that came out recently stating that Republic Airways only recently received financing for that order that they got that announced in January. Was there something different about that announcement due to the underlying host companies still operating under bankruptcy protection?

A - Frederico Curado {BIO 2004589 <GO>}

I'm not sure I understand. You're talking about Republic or somebody else?

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Q - Unidentified Participant

Republic Airways.

A - Frederico Curado {BIO 2004589 <GO>}

We are absolutely following up our (inaudible), since ever -- (inaudible) -- I don't know -- at least 15 years.

A contract is firm. And it's firm. And we have no refundable deposits on our accounts. So this is true for Republic. It was true for Republic. What was recently announced -- I'm not sure I'm answering your question. But what was recently announced was that Republic assured financing for the 47 aircraft. But the contract was firm. Commercially, it was absolutely firm between Embraer and Republic since January or February. We announced it then.

Q - Unidentified Participant

Okay. So they had done a deposit at that point then?

A - Frederico Curado {BIO 2004589 <GO>}

Oh, yes. Absolutely. (inaudible), we would not consider that firm.

Q - Unidentified Participant

Okay. Thank you.

Just one more follow-up. Now, over the long term, what extent do you think Embraer plans to continue acting as a aircraft lessor? Do you believe that the driver behind KLM Cityhopper's decision to lease 190s instead of purchasing them -- ? What do you think? Is that something that you plan on kind of integrating in your model further?

A - Frederico Curado {BIO 2004589 <GO>}

No. That's an important question. We have been focusing, clearly, in expanding our customer base also through leasing companies. As you know, leasing companies are fundamentally working with Boeing and Airbus airplanes only, except for, of course, some specific examples. But, fundamentally, the leasing industry works Boeing and Airbus product. And that's -- we see that as a very important distribution channel. And, for the last two or three years, we've been focusing a lot in expanding our customer base and opening up new lessors, not, of course, to have a enormous number of lessors but having some important ones, as we have succeeded. So having a large customer base, as we have now with 67 customers -- that attracts lessors.

So, down the road, we see a combination of direct sales and the participation of lessors. If you look at Boeing and Airbus, they probably have something between 25% or 35% of their backlog to lessors. We are not at that level. We are probably around 20% -- or 15% or 20%. We kind of see it as a healthy strategy down the road.

Q - Unidentified Participant

Thank you. That was very helpful.

Operator

Eduardo Couto, Morgan Stanley.

Q - Eduardo Couto {BIO 18009973 <GO>}

Just one question from my side on the currency side. We had this 10% depreciation on the BRL since the beginning of the year. Can you give us some color on when can we start to see the weaker currency reading back in the results of the Company? Just some color on that.

A - Unidentified Speaker

Actually, as you know, the devaluation when it affects the cost, which is positive, it has to go -- to follow the flow through the production and, then, to the delivery. So we expect to see that effect going forward; sometime still this year, definitely. But not in the very short term. The very short term, as noted, is a negative impact because of the accounting methods of the deferred income tax. But the benefit on the cost and the margin will come forward. So probably more towards the end of the year.

Q - Eduardo Couto {BIO 18009973 <GO>}

So we can say that your costs on the Second Quarter -- they are pretty much based around like a BRL2 per dollar BRL?

A - Unidentified Speaker

Definitely.

Q - Eduardo Couto {BIO 18009973 <GO>}

That's correct.

(Multiple Speakers)

A - Unidentified Speaker

It was a little bit more. By the end of the First Quarter, we had almost a little bit more than BRL2. But this level that we're having today was not a factor in the Second Quarter.

Q - Eduardo Couto {BIO 18009973 <GO>}

Okay. Thank you.

Operator

Bruno (inaudible), (inaudible).

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Q - Unidentified Participant

Just a follow-up on the previous question. The Brazilian real has depreciated significantly since the beginning of the year when you provided the market with an EBIT margin guidance of a margin between 9% and 9.5%. Don't you see upside risk to this guidance, given the move we saw in FX? Thank you.

A - Jose Filippo {BIO 1726218 <GO>}

No, Bruno. Actually, we still maintain the range. As we indicated, there are some challenges, of course, in the business activity. And so it's part of the whole impact in the year. So the margin between 9% to 9.5% (sic; see slide 12) -- as we indicated, that probably now will foresee more the low end of the range. So the exchange rate will be part of this projection that we have. So we don't see that as an upside risk at this moment -- at least at this moment.

Q - Unidentified Participant

Okay. And could you, please, try to clarify what is the part that is pressuring margins?

A - Jose Filippo {BIO 1726218 <GO>}

It's more the delivery trend. More in the revenue.

A - Frederico Curado {BIO 2004589 <GO>}

On the revenue side.

Q - Unidentified Participant

Okay. It's more about number of deliveries or prices?

A - Jose Filippo {BIO 1726218 <GO>}

It's more volume, delivery.

Q - Unidentified Participant

Okay. Thank you, very much.

Operator

I'm now showing any other questions in the queue. I'd like to turn it back over for closing comments at this time.

A - Frederico Curado {BIO 2004589 <GO>}

Well, just to thank you all for your attention and consideration. And be in touch with you. See you in the next earnings call. Thank you. And have a nice day. Have a nice weekend.

Operator

Thank you. This concludes today's question and answer session. And this concludes Embraer's conference call for today. Thank you, very much for your participation. And have a good day.

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