

Q2 2009 Earnings Call

Company Participants

- Carlos Eduardo Camargo, Head of Capital Markets and IR
- Frederico Fleury Curado, President and CEO
- Luiz Carlos Aguiar, CFO
- Unidentified Speaker, Unknown

Other Participants

- Alan Cardoso, Analyst
- Augusto Ensiki, Analyst
- Byron Callan, Analyst
- Joe Nadol, Analyst
- John Venusti, Analyst
- Luis Campos, Analyst
- Ron Epstein, Merrill Lynch
- Steve Trent, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. And welcome to the audio conference call that will review Embraer's Second Quarter 2009 results. Thank you for standing by.

At this time, all participants are in listen-only mode. Later, we will conduct a question-and-answer session. Instructions to participate will be given at that time.

(Operator Instructions)

As a reminder, this conference is being webcasted at www.embraer.com.

The 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.

Forward-looking statements are to predict risks, uncertainties. And assumptions, including among other things general economic, political. And business conditions in Brazil and in other markets where the company is present. The words believe, may, will, estimate,

continue, circumstances, intents, expect. And similar words are intended to identify forward-looking statements.

Embraer undertakes no obligations to update publicly or revise any forward-looking statements because of new information, future events, or other factors. In light of risks and uncertainties, the forward-looking events and circumstances discussed on the 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 Frederico Fleury Curado, President and CEO; Mr. Luiz Carlos Aguiar, Chief Financial Officer; Carlos Eduardo Camargo, Head of Capital Markets and IR; and Mr. Rodrigo Rosa, Controller. I would now like to turn the conference over to Mr. Curado. Please go ahead, sir.

Frederico Fleury Curado {BIO 2004589 <GO>}

Thank you. Good morning, to all.

It's a rainy, rainy morning here in Sao Paulo, very cold for our standards. But we have good news about the quarter. In summary, we had the launching of the KC-390 military transport jet program in this quarter, along also with a new contract for modernization of 12 AF-1 and AF-1A, these are A-4s, for the Brazilian Navy, our first valuable contract with the Brazilian Navy.

On the commercial airline market, we had the confirmation of options from both KLM Cityhopper and Fuji Dream Airlines in Japan. Also important to remark, we delivered our first Lineage 1000s. And the airplane has been performing quite well.

We also completed our 20-F and filed a report related to last year fiscal year.

We also had the Phenom 100 certified in Europe by EASA.

And last but not least, we delivered 1,100 ERJ 145 airframe aircraft and also the 100th Super Tucano, which was the 75th Super Tucano for the Brazilian Air Force.

So in regard to deliveries, we delivered 56 airplanes in this quarter. This is a significant improvement over last quarter, when we delivered only 40 airplanes. Those 56, they included 35 airliners, 19 airplanes for business aviation. Out of those 19, 13 were Phenoms. And lastly, we had two aircraft for defense.

That translates into a revenue of \$1.45, \$1.46 billion, which is again -- is an improvement over last quarter. Obviously, it's lower still than last year's Second Quarter, which was \$1.6 billion.

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I think it's important to emphasize that we had a chance to improve our gross margin significantly, due mainly to our productivity gains and also the cost adjustment that we implemented earlier this year.

And not only on the gross margin. But also on the operating expenses, we continued to build tremendous efforts in terms of adjusting our cost of SG&A. So we had on the sales expenses, about a 30% reduction from \$106 million last year to \$74 million this year.

And similar efforts on G&A, from about \$60 or \$59 million to \$47 million. Well with improvement in the growth margin and also the reduction of operating expenses, we were able to improve our operating margin. So we reached 12% actually this quarter and that compares to about 7% last year.

If you go -- if we consider net income, we have -- as most of you know, our income tax is still calculated by specific Brazilian legislation, which plays with the currency and the -- of taxes. So we have more -- due to the fluctuation of the Brazilian real and the U.S. dollar, we had a stronger than planned income tax accrue. That is not a cash expense. But our next margin was 4.7%, despite the high operating margin of 12%. This is a direct ratio of -- result of the Brazilian real valuation against the U.S. dollar.

Our accounts receivable and client financing have been pretty much stable, a little bit of an increase. But fundamentally stable over the last several quarters. And the total for accounts receivable and client financing amounts to \$9,982 million. I'm sorry, to \$1.05 billion. We were able to reduce about \$200 million in our inventory.

So as we go throughout the year, we see some trends to further reduce this inventory, by addressing the overflow of the reduction in Brazil in the first half. So this is good news too.

We also managed to lower our debt -- indebtedness costs, especially on foreign currency. And our indebtedness has reached \$1.8 billion. We still produce a cash -- a net cash -- a positive net cash. So our cash is higher than our -- our cash position is higher than our indebtedness. And we ended the quarter with \$52 million of net cash on our balance sheet.

Backlog is still holding at \$19.8 billion. And that's probably due to this important contract in defense.

And as far as the 170-190 family goes, we stand with 328 firm orders as of the end of last quarter.

So with that, I'll turn it to question-and-answer. And we'll be glad to take any questions you may have. Thank you.

Questions And Answers

Operator

Excuse me, ladies and gentlemen. we will now begin the question-and-answer session.

(Operator Instructions)

Excuse me, our first question comes from Mr. Joe Nadol with JPMorgan.

Q - Joe Nadol {BIO 3056499 <GO>}

Good morning.

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

Good morning, Joe.

Q - Joe Nadol {BIO 3056499 <GO>}

Fred, congratulations to you and the team on outstanding operational results. I think this is really a breakout quarter.

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

Thank you, Joe.

Q - Joe Nadol {BIO 3056499 <GO>}

I know it took a lot of hard work. I wanted to get your perspective here on the 170-190 demand outlook.

As we look forward, how good do you feel about the security of the 150 or so deliveries this year?

Then as you look into next year, where are you in terms of aircrafts sold out that you feel comfortable with? You know, the customers are going to take deliveries, et cetera.

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

Well we feel very comfortable -- well, let me start by talking about new sales. As you can see, not much activity in terms of -- lot of activity, not much results in terms of new sales. The market is too depressed. We do not see many campaigns out there. We feel very, very comfortable about deliveries this year meeting our guidance.

Next year, as we have already mentioned a few times, we have not only the current customer financing challenge that we have been successful so far, we also have a bit of a sales challenge next year to fuel what we -- we tend to be as flatish as possible production rates.

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We shall, Joe, in October -- we're going to provide guidance for 2010. So we are really coming down to finalizing our production plan for next year. So today would be a little bit too early for us to make any more concrete assumption on next year.

But as I said, we have a double challenge. We have challenges in customer finance, same as what we have this year. But also we have to sell a few aircrafts to to fuel our production line for next year.

Q - Joe Nadol {BIO 3056499 <GO>}

When you look at your margins, there's obviously a number of factors going on. You have your productivity improvement which we really see the benefits of this quarter I think.

You have currency that, once again, unfortunately is working against you. And the real just continues to strengthen here over the past couple of months. And I think you probably have more productivity improvements planned, for example that moving line that we've been talking about.

So as you put all these together and you look at your 12% that you put up this quarter for operating margin, how sustainable do you think that is as we go through the year? How do you see the profile playing out, considering the currency and also the further improvements?

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

It is difficult to -- I mean, the impact of the currency is sizable. Every 10 cents in the exchange rate, I mean, it's something between 0.3% or 0.5% of our margin.

Productivity, I mean, the effort is there for sure and will be improving. We have also taken into account product mix.

So clearly, it's different than those quarters where we had higher number of deliveries in terms of Legacies and larger E-Jets. You know, the cross market tends to be higher.

So I see that as a continuous struggle. So I don't think we -- I mean, we are still working for the 10% margin this year, clearly. But as the currency goes down, as it is going down, it may be difficult to sustain the 10%, I would say, exclusively because of that.

Otherwise, we would feel very comfortable. If we basically reproduce this quarter the next few quarters, we would be there. I think the wildcard there is clearly FX.

Q - Joe Nadol {BIO 3056499 <GO>}

Right. Okay. Then just one more on business jets.

Can you speak just a little bit to the Phenom ramp up? I think it's happened a little more slowly than you expected but you're making progress.

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How do you feel about the outlook for Q3 and Q4 on the 100? Then you know, an update on the 300 as well.

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

Okay. We have delivered 21 Phenoms in the first half. So that leaves like 89 for the second half which is a it seems a huge number. And it's a challenge, no question.

We are foreseeing that we can deliver something between 34 and 39 aircraft in this quarter, which will take us to 55 or 60 airplanes delivered through the three First Quarters of the year. So if we meet that, between 55 and 60, then I think we will feel even more comfortable than we do right now.

I -- industrially, I have less concerns. We are producing I think probably number 70 or so in the assembly line right now. We have had a few cancellations and we moved to have them move up and those move ups, they are not like overnight. You have to sometimes reconfigure the airplane a little bit.

So I -- fundamentally, I do not see any major hurdle to fulfill our number. Commercially, I think we have a few challenges, especially to speed up and turn eventual cancellations into rapid move ups.

Having said all that, we choose to stay and do 110 Phenoms this year. Remember that we may have some take in from a few Phenom 300s as well -- maybe two or three Phenom 300s at the end of the year. I definitely -- I do not see a challenge of a threat to our \$5.5 billion revenue.

So that's where we are. I think next quarter by reaching 55 to 60 airplanes delivered the picture will be much more clear.

Q - Joe Nadol {BIO 3056499 <GO>}

On the 300, you're tracking according to or close enough to schedule that you feel comfortable you'll get certification by yearend?

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

Yes. That's correct. The production campaign is going into the final stages and we plan to deliver a few of them before yearend -- before Christmas, actually. So that two or three. Value-wise, one Phenom 300 is worth two Phenom 100s.

So again, I think on the airline side we feel pretty good and revenues I think our numbers are solid. And the 100 Phenoms, they are viable they are physically viable. If we miss a few of them only, I don't think that will have any material impact to our plans.

Q - Joe Nadol {BIO 3056499 <GO>}

Okay. All right. Thank you.

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

Thank you.

Operator

Excuse me. Our next question comes from Mr. Steve Trent with Citigroup.

Q - Steve Trent {BIO 5581382 <GO>}

Good morning, all. Just one or two -- hi, just one or two from me if I may. I was curious if there's any update on Brazil's jet fighter program. I believe the government boiled it down to the three finalists -- Boeing, Saab. And Dassault, if I'm not mistaken. And I'm wondering if you're seeing anything new with respect to potential timing on that.

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

Well as you may know, Steve, they -- those three, you're right, that's the short list. Those three, they had delivered the best and final. So our understand -- I mean, we do not have a direct participation on the deal.

We're not building ourselves. We have executed kind of a memorandum of understanding with all three pertaining to a potential scope of work and technology trends for if each one of them wins. So that's the architecture of our participation in this transaction.

So our understanding is that the Brazilian Air Force and the Ministry of Defense, they are evaluating the proposals and having some interactions with all three. Their decision day is targeted for the next couple of months or so. That's what we know. So no real insight on the evaluation. We are really not part -- a direct part of the process. But we will be as soon as they define the winner. Then we will start to engage ourselves into discussion of more concrete work scope, both manufacturing and engineering.

Q - Steve Trent {BIO 5581382 <GO>}

Great. Thanks, Fred.

And just one other thing for now. As we think about the real's movement versus the dollar, you guys put out some what I thought were very helpful statements late last year on your derivative strategy and how there is no leverage component to it and that sort of thing.

Could you give us some color as to how you are thinking about the currency risk moving forward with respect to derivative strategy?

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

Yes, I'll just say a few words and invite also Luiz to jump in and make some remarks. We -- I'm -- we've been trying to do what I -- I mean, as a joke, I call it operational hedge. So cutting costs really has no negative collateral.

So we've adjusted our costs to be viable. Of course, if the currency rate goes much deeper than what it is right now, that's going to be a real challenge.

So we have a clear policy approved by the Board, which gives us flexibility to do or not to do opera -- I mean, cash flow hedging. And that's an option which is always there. So the volatility is it's still a concern for us. I don't think we're in a position to say today are we going to hedge our position and are out of exposure for the next several quarters, because we are sure the dollar will keep going down because what happened last year, for example, with an overshoot of 30% or so at the end of the year, the fundamentals were not there to have that overshoot.

That's a lot of volatility. So we keep our options open, working on the front, which has no downside, which is the cost and the expense control. But Luiz, do you want to add anything or --?

A - Luiz Carlos Aguiar {BIO 6035667 <GO>}

I think that's pretty much it. I'd like just to make one comment regarding the currency fluctuation here. If you compare this quarter with the '08 Second Quarter, we're going to see 25% devaluation. If we compare with the last quarter, you are going to see the opposite of this, appreciate of the reais in terms of 10%. I mean, huge volatility. We are not sure what's going to happen. To be honest, nobody knows about it, you know.

And that's why we needed to protect our cash and we prefer to work hard in terms of reduction of our costs and expense internally, in reais especially, right? A lot of them taking right now exposure, huge exposure in order to try to hedge something that they don't know what's going to happen in the near future. That's our position right now so far.

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

Yes. We may do it if we have a more, let's say, if we are more convinced than we are right now that this trend is there and it will be a negative trend. So we may do some hedging of our cash flow, of course only on the reais expenses. But so far, we have not done any new operations since the liquidation of the last one.

Q - Steve Trent {BIO 5581382 <GO>}

Okay, that's very clear. Appreciate the color on that.

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

Okay. Thank you, Steve.

Operator

Excuse me. Our next question comes from Mr. Ron Epstein with Bank of America-Merrill Lynch.

Q - Ron Epstein {BIO 15893287 <GO>}

Hi. Good morning, guys.

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

Hello, Ron.

Q - Ron Epstein {BIO 15893287 <GO>}

A couple questions and to follow on to his comment, congratulations on the great operational quarter. So I know it was a lot of work. So well done. What's your competitive reaction to -- when you look in the kind of 80 to 100 seats market, you've got the Super Jet 100 coming in, right? They were flying that around Paris. You've got the Mitsubishi jet.

When you look a little bit larger in the market, right, you've got the C Series sitting right between 110 and 130 seats. But how does that change your thinking or how does that impact your thinking about how you should position yourself with your next airplane?

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

Well I really don't have anything new on that, Ron. We are when we look to the airline market in our own segment, the segments where we are in right now and the next one which would be let's say something with below 250 seats, we've been monitoring. And studying. And talking to these airlines for a long time. Again, we have three concepts of what may become a new product. We are looking at -- this aircraft is going to be viable again in, let's say, the sub 100 seats segment.

That question -- the answer to those questions are not in our design offices, they are with our customers. And there is an absolutely unclear answer to that question today. Some airlines are absolutely convinced that a larger tour craft is the best airplane for the next 20 years. Some are opposite to that opinion. So that's one thing.

Another, let's say, another front would be what could be a next generation E-Jet, differently from the 145? 50 seaters, not only the 145, different from the RJs 50 seat RJs which were which boomed due to the scope of it in the United States.

The E-Jets, they have not at all been -- their demand has been created by scope clauses. It's a natural -- there's a natural segment there. We have occupied that segment I think very efficiently. The airplanes are performing brilliantly, not being -- this is not an overstatement.

They've consistently been surpassing our reliability targets. So the E-Jets are making money for our customers. And we -- I mean, this product line is there to be for many decades. That's our view. Of course, as we have seen in several other airline airliners in our history, the industry's history generations may evolve. So that's something which is always possible. Reengining of the E-Jets is a possibility, it's a possibility of course not right now. It's obviously in the radar screen.

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And we also have thoughts about a larger aircraft, something more in the the next segment to where we are right now. So something above the E-Jet. Any decision of our next move I think has to take into account a few variables which are still moving, still undefined. First Q1 is engine or engine configuration. Looks like maybe for the next until end of next year or something or early 2011, GE will come up with more concrete conclusions about what is in the architecture.

GE is clearly going towards the three shaft technology, right up there with DTS. So there will be more information about DTS as well. And Rhodes is doing a lot of research on both the three shaft, advanceable rotor. And also the open rotor. So it's early to make, let's say, to make bets on what is the best engine configuration for next generation of aircraft.

And last but not least, this competitive environment and I think to imagine that we are indebted from our competitors and also from people like Boeing and Airbus, which are in the higher segment, we have also to take a look on their movements.

So where we stand right now, we have a very powerful product portfolio. The E-Jets are up to date aircrafts, they are modern aircrafts, they are money-making machines. And we are doing a lot of research, not only on the technological side but also with our customers to define which and when we make the next move.

We are preparing ourselves, Ron, to make that move. But we do not want to put the horse in front of the cart.

Q - Ron Epstein {BIO 15893287 <GO>}

Sure, sure. Here maybe just a quick update to on the -- we didn't talk about it yet, the two new Legacies, the 450 and 500, I mean, how are those development programs going? Can you give us a little update there?

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

Yes. They are going quite well. We are -- as every new development program that we have, I think we are improving the overall program management. If we take the ramp up on the Phenom and the level of the maturity of the aircraft as far as engineering changes and reliability of the components it's an improvement over the E-Jets. The E-Jets were a huge improvement over the 145 and so forth.

So you know, doing the design reviews and I do participate in some of the overall program reviews, I feel very comfortable about this aircraft. No major technical difficulty or anything of the sort. Supply chain running okay as far as development goes. As far as I can tell you today, I think it's a robust program management and product development we are doing right now.

Q - Ron Epstein {BIO 15893287 <GO>}

That's great, great. Thank you very much.

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

Yes.

Operator

Our next question comes from Mr. Augusto Ensiki with Morgan Stanley.

Q - Augusto Ensiki {BIO 15988025 <GO>}

Hi. Good morning. Most of my questions have been answered. But if I may, do you see any potential recovery in business jet demand going forward or in the past few weeks or so?

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

Well not really. I mean, it's been stable. It's not getting worse. But it's stable at a very low level. You know, some positives here and there the Phenom. The Phenom in Brazil, it should take, let's say, what would be a natural market share of Phenoms. In Brazil, I think we have been very successful in placing Phenom. I think the presence -- our presence in Brazil is probably the reason for that.

You know, the larger aircrafts, as everybody else, we're also -- the demand has been very soft. So there's a lot of used aircrafts for sale and in some cases semi-new aircrafts on sale in the internet and across the industry. So I -- we do not work with a very brilliant scenario with business jets for the short and midterm. We think the recovery will take probably a little bit longer and maybe even in the airline market.

Q - Augusto Ensiki {BIO 15988025 <GO>}

And you said that cancellations have stopped?

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

I think in terms of massive cancellations, yes. We have pop ups here and there. And as I think I mentioned in the Phenom, some people just cannot take delivery the last time and as we have a strong backlog, we have a lot of move ups. I think we also moved one Legacy recently, which in the end that was a cancellation.

But you know, as a trend or as something massive, I think it's pretty much stopped. So hopefully it stays like this and then we resume growth sometimes this year again. We do not have an over-optimistic vision on this segment.

Q - Augusto Ensiki {BIO 15988025 <GO>}

Okay, good. Thank you very much.

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

Thank you.

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Operator

Excuse me, our next question comes from Mr. Byron Callan with PW Partners.

Q - Byron Callan {BIO 1498699 <GO>}

Yes. Good morning, gentlemen.

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

Hello, Byron.

Q - Byron Callan {BIO 1498699 <GO>}

Hi. Fred. Two things. I wonder if you just want to follow up a little bit more on the fighter program. I mean, how big could that be? I assume there's been talk that some of the airplanes could be assembled in Brazil. Is there any way to even bracket the value that might accrue to Embraer, assuming this moves forward over the next couple of years?

That's my first question. Then a follow up, if I may.

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

Sure. This -- the RFP does not specify whether or not the airplane is to be built in Brazil. My understanding is that the Brazilian Air Force, actually the Ministry of Defense, ultimately decides on that matter.

Obviously, we do not have access to the proposals themselves. We do not know if the proposals contain like option A with assembly, option B without assembly, or if this will be a follow on discussion between the Brazilian government and the winner. We do not know that.

But I do know that this decision will be a governmental decision and therefore to make -- to put a bracket or any number at this day would be hugely premature and probably too generous also for me.

Q - Byron Callan {BIO 1498699 <GO>}

Okay, fine. The other question was just on margins. I mean, obviously, there's a very impressive margin this quarter. You know, the age old question pops up how sustainable is it? Gross I assume is sustainable. But maybe there is more pressure on selling and general administration as the market starts to come back. Help me frame that out a little bit.

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

Yes, I think that's very fair -- a fair question. We -- if you take the three elements, I think to take like the quality of the revenues. So pricing. Pricing, to take -- which comes with product mix, of course. If you take the cost side and the FX effect, the only, I mean, the -- I feel very comfortable about the sustainability of the cost element. So what we have done

in the quarter is there and is there only to be improved. Obviously, improvements like what we have been doing the last few years, they are not step functions. I mean, we are gradually going.

And of course, as we improve to get every extra inch, it is more difficult. But this is definitely our commitment and our absolutely -- I would say it's our obsession. We're pushing that very strongly. Product mix may move, product mix and pricing. Contract mix may fluctuate from quarter to quarter. So this was a good quarter. This Second Quarter was a good quarter. And the variable which is more outside our control is the FX.

So at 1.9, where it is today, like 1.88 or something it's something which probably is going to have an impact on our numbers, not significantly. Where does this (inaudible) go? Does it go back to 2.1, does it go back to 1.6 as some people are talking about? It's really hard. So I mean, between controlling our operation and, as we've mentioned, having the ability to hedge some of our reais cash flow if we feel that it's the right thing to do, we will fight very hard to protect our operating margin.

Q - Byron Callan {BIO 1498699 <GO>}

Okay. Thanks a lot.

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

Thank you, Byron.

Operator

Excuse me, ladies and gentlemen.

(Operator Instructions)

Our next question comes from Mr. Alan Cardoso [ph] with Agora Cojedora.

Q - Alan Cardoso {BIO 15933677 <GO>}

Hello, all.

My first question will be about the EBIT margin guidance of 2009. Now that you've had an exceptional quarter, do you think that it's more achievable to meet the EBIT margin with the dollar in the current levels?

A - Luiz Carlos Aguiar {BIO 6035667 <GO>}

This is Luiz Aguiar speaking. Well we are maintaining our guidance in terms of 10%. But of course there is a risk on that, especially because of the foreign exchange. I think Fred mention that each \$0.10 in foreign exchange rate, we can gain or lose around from 30 to 50 basis points. Then it means that we are going to take this risk and there is no other way.

But in terms of our operational side, if you look at the operational side, we are pretty much -- we believe that we can reach 10%, taking in consideration the foreign exchange risk that I just mentioned.

Q - Alan Cardoso {BIO 15933677 <GO>}

Okay, my next question will be about net cash. In the last two quarters, where we've seen reductions in the net cash position of the entire, should we expect a change or do you already expect the net debt to mature in the Fourth Quarter?

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

As a matter of fact, we have been improving our cash position, even though if you look at only the final results and you compare \$53 million net cash with \$122 million it seems that we have been getting worse. But it's not. If you look at cash, especially the operational cash flow, we are coming from negative \$230 million in the last -- in this quarter, we posted only \$53 million still negative.

But that's a great improvement, no doubt about it. In the First Quarter, you'll remember that we had -- we took some time to lay off people, around -- it was February 20, 50 days paying wages. And we had the expenses of the dismissal. We had a huge account in terms of our suppliers. And we made a huge adjustment in all of those accounts and we have been improving a lot. We can see that in our cash flow -- our cash flow consolidated statement that we have been reporting today. We can see that if you compare with the First Quarter.

And I would say that net cash is not enough -- is to look at net cash amount is not enough to evaluate the improvement of our cash flow. I recommend that you take a look carefully on our cash flow statement and then can see what I -- can see carefully what I am saying right now.

Q - Alan Cardoso {BIO 15933677 <GO>}

Okay. And I would like to congratulate you on the results. They were really exceptional.

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

Thank you.

A - Unidentified Speaker

Thank you, Alan.

Operator

Excuse me. Our next question comes from Mr. John Venusti with Kynikos.

Q - John Venusti {BIO 4281622 <GO>}

Yes, hi. Good morning. Just a couple quick follow up questions from me if you don't mind. In your backlog for the quarter, can you kind of talk about some of the different parts of your backlog there? You know, what's in commercial, what's in executive. And what's in defense. And how maybe those pieces changed over the last quarter and what your outlook is going forward?

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

Absolutely. Carlos, can you help me?

A - Carlos Eduardo Camargo {BIO 20195335 <GO>}

Yes. John, in terms of breakdown of the backlog, we have seen the backlog for executive aviation has been around \$6.4 billion. It has been a very slight decrease. It was around \$7 billion. For defense, it has shown the biggest increase. That backlog has reached close to \$3 billion, it's around \$2.8 billion. It went up from \$1.5 billion. And the remainder, \$10.5, \$10.6 billion, has been for the commercial aviation.

Q - John Venusti {BIO 4281622 <GO>}

Great, thank you for the clarity. Just real quick on that, the \$1.5 billion, is that a yearend number for the defense or was that a Second Quarter number?

A - Carlos Eduardo Camargo {BIO 20195335 <GO>}

No. Those are all Second Quarter number.

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

Before the increase, right? He is asking --.

Q - John Venusti {BIO 4281622 <GO>}

Yes, before the increase. The \$1.5 billion going to \$2.8 billion, I'm just curious when that \$1.5 billion was.

A - Carlos Eduardo Camargo {BIO 20195335 <GO>}

Oh, okay. That was by the end of the First Quarter.

Q - John Venusti {BIO 4281622 <GO>}

That's end of First Quarter?

A - Carlos Eduardo Camargo {BIO 20195335 <GO>}

Yes. And Fred announced we signed the contract with the Brazilian Air Force, the Brazilian Navy, which increased that by \$1.4 billion.

Q - John Venusti {BIO 4281622 <GO>}

Right. Okay. Great. Thank you. On that also, can you talk about your R&D expectation for the rest of the year? You know, R&D is down and I'm assuming that's because of the lower development costs for the Phenom programs. But with the Legacy out there as well as the Lineage, can you just talk about your expectations going forward through the rest of the year and into 2010?

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

When you say lower, it's lower compared to what, to last year?

Q - John Venusti {BIO 4281622 <GO>}

Yes.

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

Okay, well, there is a fundamental difference in the way we account. If you compared our \$48 million in this quarter to the \$46.3 million the First Quarter. So that shows a very consistent number, which leads by the way to meet our guidance, which is \$200 million in R&D for the year -- about \$50 million -- roughly \$50 million per quarter. You know, the only -- again, the only wildcard there would be a severe change in currency exchange. But we are on track for those \$200 million.

Last year, we -- those numbers -- sorry, those numbers, those \$48 million, they are already net of the contribution from our partners. So the way we account from this year one, we've been accounting, accruing as we go in a pari passu way. Last year, we had more like events. So we had a huge recognition of funding at the end of the year, the last quarter. So we showed a higher number throughout the year and then a very low, even in a negative number in the last quarter.

So the way we are counting right now we believe gives everybody -- not only ourselves. But yourselves -- a much easier planning and follow up model.

Q - John Venusti {BIO 4281622 <GO>}

Okay. So that's going to be consistent going forward even with the contributions from partners for some of the programs over time, you're still going to be accounting for it under this methodology?

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

That's correct. But that dilutes over throughout the year.

Q - John Venusti {BIO 4281622 <GO>}

Okay. Final question from me, if you don't mind. I'm sorry?

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

Yes, no, go ahead.

FINAL

Q - John Venusti {BIO 4281622 <GO>}

Sorry, just on accounts payable, obviously you saw a big decline quarter over quarter and I'm assuming that's because of negotiations with your suppliers. And I'm just wondering is AP at more of a balanced level now? Is that kind of the level we can look at going forward? Or with the with the expected downturn in inventories over the rest of the year, can we see AP coming down further as well?

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

Yes, yes. Basically, we had in the First Quarter, we had some negotiations of financing or payments deferred with our customers. So we basically liquidated all those positions that resulted in this \$300 million reduction. Looking for what would be the --?

A - Unidentified Speaker

Yes, remember that we made a comment when we announced the First Quarter results by saying that we have expected to still the reduction in our supplier's accounts payable in the second semester of this year. As a matter of fact, we have been successful so far and we started reducing even in the Second Quarter. I would expect to see this trend for the rest of the year. It's not quite clear for us, how much we will be able to reduce it. But for sure it's going to be a trend.

Q - John Venusti {BIO 4281622 <GO>}

Okay. Great. Thank you very much, I appreciate the answers.

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

Thank you, John.

Operator

Excuse me. Our next question comes from Mr. Luis Campos with Credit Suisse.

Q - Luis Campos {BIO 1750845 <GO>}

Hi. Good morning, everyone.

I just had one follow up question on the R&D side. The way I understood, you would still have in the Fourth Quarter something around \$50 million of reversal of R&D related to the Phenom 300 certification. Am I wrong and you're going to be reporting really \$50 million each quarter more or less? Thank you.

A - Carlos Eduardo Camargo {BIO 20195335 <GO>}

Hi, Luis, thank you for your question.

As Fred mentioned, we expect to have R&D expense pretty much in the same level throughout the year and we have already -- we have our guidance, \$200 million. We have

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already spent like 50% of this and then we expect to spend the rest, 50%, for the next two quarters.

Q - Luis Campos {BIO 1750845 <GO>}

Okay. Thank you.

A - Carlos Eduardo Camargo {BIO 20195335 <GO>}

You're welcome, thank you.

Operator

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

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

Thank you, all again for being here. And we are just going through the crisis, six months have passed and I think we can look behind, look behind us and see that I think we have done our homework in the last six months and next six months, new challenge. So we'll keep working with the same stamina, with the same determination as we have. Thank you very much to all. Have a nice day, nice weekend.

Operator

That does conclude Embraer's Audio Conference for today. Thank you very much for your participation and have a good day.

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