

Q1 2014 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.

Other Participants

- Cai von Rumohr, Analyst
- Derek Spronck, Analyst
- Joe Nadol, Analyst
- Myles Walton, Analyst
- Noah Poponak, Analyst
- Pete Skibitski, Analyst
- Ron Epstein, Analyst
- Stephen Trent, Analyst
- Turan Quettawala, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. and welcome to the audio conference call that will review Embraer's First Quarter 2014 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 statement about events or circumstances which have not occurred. Embraer has based these forward-looking statements largely on its current expectations and projections about future events and financial trends affecting the business and its future financial performance.

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

Embraer undertakes no obligation to update publically or revise any forward-looking statement 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 forward-looking statements.

Participants on today's conference call are Mr. Frederico Curado, President and CEO; Mr. Jose Filippo, Chief Financial Officer and IRO; 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>}

Good morning, all. We'll go through the presentation. I'll ask Filippo to do that. Then I'll be back, too, for Q&A. So Filippo, will you please walk us through?

Jose Filippo {BIO 1726218 <GO>}

OK. Thank you, Fred. So we'll start the presentation; our First Quarter 2014 earnings results in page three where we have the highlights of the business. So starting with our highlights for commercial aviation, as we already indicated in our backlog statement in mid-April, we delivered 14 E-Jets in the First Quarter, with that, reaching over a 1,000 deliveries of the E-Jets since the beginning of the program.

Another important milestone of the E-Jet program was the celebration of the 10th anniversary of the first delivery that happened.

And now in relation of new orders, as previously announced, we had the Air Costa from India order, that placed an order of 50 E-Jets E2, plus 50 options of models 190 and 195 E2. This was already included in our backlog for the First Quarter.

Another reported achievement was the beginning of the delivery of the E-Jet 175, featuring aerodynamic improvements, which now able to reduce the fuel burn by 6.4%.

In terms of market share, we continue to consolidate our leadership position. In the First Quarter of 2014, in the segment of the 70; to 130-seats, we had 50% of the sales and 60% of the deliveries worldwide.

Turning into next page with the executive jet business, we delivered 20 executive jets in the First Quarter, broken by 17 light jets and 3 large jets. This represents an increase over 60% when compared to the First Quarter of 2013. And with that, we expect a better balance delivery profile for the year.

We also had important milestones in the executive jets program with the delivery of the Phenom 100, number 300, after five years of entry into service, and the opening of

Embraer new executive service center in the city of Sorocaba, in Brazil.

And finalizing the executive jet business, confirming this business maturity, Embraer reached the milestone of 1 million flight hours in its fleet of over 740 aircraft.

Next page, in relation to defense and security, in the development of the LAS program, we started the assembly of the first Super Tucano aircraft. And we expect the first delivery to be happening in mid-2014.

In terms of the modernization program, Embraer's entry with the Brazilian Air Force, we received the first fighter jet, F-5, of the total of 11 for the modernization program.

Another highlight that through our subsidiary Atech, was the beginning of the operations of the Amazon Air Traffic Control Center.

Finalizing the defense and security highlights, in terms of the Sisfron project, we are also advancing as planned, and concluded the delivery of the first military operations center, recently.

Now turning to next page, the firm orders; the backlog; as we released on April 15th, we reached a total of \$19.2 billion of firm orders in the end of March. This is the highest level since the Second Quarter of 2009.

Next page, as far as deliveries, in commercial aviation, the left side of the sheet; we delivered 14 aircraft, which was slightly below our plan. But we expect to recover going forward in the Second Quarter.

In executive jets, on the right side, we had a good First Quarter with a total of 20 aircraft delivered, broken by 17 light jets and 3 large jets. And for this business we expect a better delivery profile for the year, with less seasonality.

With that, we are maintaining our guidance figures for 2014. They were in the range of 92 to 97 E-Jets, 25 to 30 executive jets large, and 80 to 90 executive light jets.

Next page, in terms of revenue, as a consequence of the deliveries in the previous slide and also together with the defense revenues, we had a total of \$1.2 billion in the First Quarter, which broken by segment, we have \$555 million with commercial aviation, \$267 million in executive aviation business, and \$394 million in defense.

In defense, we had a strong First Quarter, helped to increase the typical light First Quarter revenues. If we broke percent relatively through these business units, we had 45% of the revenues coming from commercial business, 21% coming from executive business, and 32% from defense. We are, in this case, maintaining and confirming our guidance range projections for the year.

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Next page, page 9, total revenues in US dollars and Brazilian reais; both increasing when compared with the First Quarter of 2013, with the reais figures also helped by the exchange-rate effect, which increased this amount.

Next page, as for SG&A expenses, we continued to see solid control of expenses, reaching \$140 million in the First Quarter. We had some tailwinds in the First Quarter, especially related to exchange rate. But although we don't expect this level to be repeated in the following quarters.

Page 11, next page, as far as EBIT, we reached the total of \$92 million in the First Quarter, with a margin of 7.4%. This result was primarily driven by the high First Quarter revenues, coupled with a lower SG&A and research expenses. We are maintaining our guidance, unchanged for the year, in the range of \$540 million to \$620 million EBIT, and a margin of 9% to 9.5%.

Next page, in relation to EBITDA, following the similar pattern that we saw in the EBIT figures, we reached a total of \$151 million in the First Quarter with a 12.2% margin. We are also maintaining our guidance range for 2014.

In page 13, next page, net income; we had a net income of \$111 million in the First Quarter, with an 8.9% net margin, reflecting the positive operational performance. An important effect was also the positive deferred income tax resulting from the exchange rate fluctuation where the real had a stronger position against the dollar in this quarter, and that affected the deferred income tax, which also helped the level of income that we're reporting.

In page 14, next page, in relation to inventories; we reached a total of \$2.5 billion in the end of March. This figure is in line with the business seasonality and with the previous year end of quarter.

In page 15, as far as cash flow, we had an outflow of \$404 million in the First Quarter of 2014. The majority of \$273 million was used in the operations to prepare for the ramp up in revenues and deliveries for the remaining of the year. But we also had some investments in PPE and development, which amounted to the total of \$131 million.

We expect to see a reverse of this pattern more towards the end of the year, reaching our guidance of positive low double digit.

In next page, in relation to investments, we had a total of \$39 million investments in the First Quarter 2014, broken by \$9 million in research, \$25 million development and \$5 million in CapEx. In general, we expect investments to ramp up throughout the year, and meet our guidance figures of \$650 million in 2014.

Next page, finalizing this presentation in page 17, we show information related to our capital structure, where we continue to see a comfortable debt profile with 5.9 years of

average maturity, and a total debt of \$2.22 billion, of which only 4% will mature in the next 12 months.

In relation to our cash position, we had in the end of March, the total of \$2.27 billion, thereby resulting into a net cash position of \$53 million.

With that, we'll finalize this presentation, and now with Fred and the team, we are ready for the questions. Thank you.

Questions And Answers

Operator

(Operator Instructions) Cai von Rumohr, Cowen

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

Yes. Thank you. And good quarter. So your government sales were particularly strong, \$394 million. I guess your guide is \$1.2 billion to \$1.3 billion. Why was it so strong in the quarter, given that my understanding is the LAS deliveries only begin about mid-year and what do you look for, for the rest of the year? Is that a number that could be conservative?

A - Jose Filippo {BIO 1726218 <GO>}

OK, Cai. Thank you for the question. Actually we have in this First Quarter, in defense, we had some activities in terms of revenues more associated with the KC-390 program. Also with the LAS and the Sisfron, together, coupled with the satellites. So we had this situation. We don't expect to see this repeating, this level, for the other quarters. So we are maintaining our guidance range for the defense business, which will reach the levels that we indicated. So it was a positive thing for the quarter, but this will probably adjust throughout the year.

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

Then following up, you did substantially better than I think most of us expected, in terms of G&A, selling and research. Maybe give us some color on where those numbers are expected to be and kind of the pattern of ramp as you go through the year.

A - Jose Filippo {BIO 1726218 <GO>}

As we said, we think that the SG&A is something that, as we've been saying, is a focus that we're putting a lot of control and a lot of monitoring. The First Quarter, we had the benefit of the dollar against the real, compared to the previous year. This helped the reduction of these expenses. And some reduction in some expenses in selling, specifically for the quarter. So we understand that this level that we saw last year could be our trend for the year.

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

OK. And the last one; could you give us an update on some color on Bizjet demand, what you're seeing in the market?

A - Frederico Curado {BIO 2004589 <GO>}

Hi, Cai. This is Fred. So it's not much of a big change from our last call. Positive signs in Europe, though, which is interesting. We are feeling good as far as maintaining our level of activity. So we are seeing some activity in the United States, that recovery, the trend for recovery is there; not to make anyone very bullish about it, on the segments where we are in.

Of course the upper segments, things are going better. But it's so far so good. Middle East reduced demands. China, there is a slow in demand as well. There is this anti-luxury, if you will, sentiment in the Chinese market now. We don't see that as something which will affect the long-term prospects of that market, but it is certainly affecting in the short term. So that's a nuance that we're (leaning) as well.

So maybe just one more comment. Brazil, which has been a strong market for us, we are seeing some slowdown, nothing to do with I think the market itself, but the overall concern about of course an election coming up. So there is a natural pause in the campaigns. But having said that, we are still grabbing most of the market share in our segments here.

So I think that's kind of a big picture.

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

Thank you very much.

Operator

Turan Quettawala, Scotiabank

Q - Turan Quettawala {BIO 6362141 <GO>}

Yes. Good morning. I guess maybe just a couple of clarifications first off. On the SG&A side, I think you mentioned that want to keep the trend for the year. Do you mean that as sort of an absolute level in dollars, or do you mean in terms of percentage of revenue?

A - Jose Filippo {BIO 1726218 <GO>}

(inaudible) Turan. Basically, our projection is around \$160 million by quarter. That's what we saw mostly last year. That's what we expect to see, which will be about 11% of the revenues.

Q - Turan Quettawala {BIO 6362141 <GO>}

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Thank you, perfect. And I guess also just on the defense revenue. So I guess the majority of that in the quarter came from Brazil, correct?

A - Jose Filippo {BIO 1726218 <GO>}

Correct.

Q - Turan Quettawala {BIO 6362141 <GO>}

OK. Maybe you can give us some update on the KC-390 Fred, how is that progressing? Still on track, I guess, for first flight by the end of the year? And maybe discuss just the next few milestones on that.

A - Frederico Curado {BIO 2004589 <GO>}

Sure (Myles), we are assembling the first prototype. There are two prototypes in the contract. So the deliverables of the development contract are two prototypes and the whole industrial tooling and of course the IP, that's deliverable.

So first airplane being built in (inaudible) as we speak. Things are still pointing out for flight before the end of the year. The classic challenge is out there, of course, it's systems integration. But it's lookingâ€”there's nothing that tells us today that we are prevented from flying before the end of the year.

And of course, in parallel, I think the important milestone for the program this year is to assure the contract for the serialization of the aircraft for the Brazilian Air Force. And from that point on, we'll then be able to start our sales efforts for exports. So it's going well.

We will probably be releasing some pictures of the airplane in final assembly soon, I suppose. I'm not sure that'sâ€”I don't think it's classified. That's something nice to be seen. It's a big airplane. It's very impressive when you get close to it and see it on the assembly line.

Q - Turan Quettawala {BIO 6362141 <GO>}

Sounds good. Look forward to the pictures. And I guess maybe just last question; Fred, on the Bizjet side, this quarter it seems like this year I would say you are getting more of an improvement earlier on in the year in terms of deliveries. Your deliveries have been more backend loaded for the last few years.

I guess my question isâ€”is it fair to assume that now you're selling more to a backlog, as opposed to maybe the last couple of years, I guess there were more spot deliveries, sort of towards the end of the year. Is that a fair assumption?

A - Frederico Curado {BIO 2004589 <GO>}

It's a fair assumption as far trend. We are not clearly where we would like to be. This is businesses jets, right, specifically?

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Q - Turan Quettawala {BIO 6362141 <GO>}

Yes.

A - Frederico Curado {BIO 2004589 <GO>}

So yes. I would say we are reducing the seasonality effects. But we still have some ways to go to have a real stable backlog and not being rushing for this roller coaster every quarter. But the trend is absolutely in that direction, yes.

Q - Turan Quettawala {BIO 6362141 <GO>}

That's very helpful. Thank you very much.

Operator

Derek Spronck, RBC Capital Markets

Q - Derek Spronck {BIO 17904184 <GO>}

Good morning. Can you comment on any commercial sales campaigns, in particular, as you head into Farnborough?

A - Frederico Curado {BIO 2004589 <GO>}

Sure. First of all, we would not really target—I don't anybody does that anymore, target the airshow as kind of the big splash of orders, because as soon as we get them, we have to announce them. So how are we in general?

We are still looking for a book-to-bill equal or above 1 for this year. So last year we had a formidable year in terms of sales. We do not expect to repeat that year in 2014. But having said that, as I said, we do expect to sell more than we deliver this year.

Overall, the activities for both E1 and E2 in Europe, in Asia, maybe a couple of campaigns in Africa as well. Middle East is kind of slow at this stage. Brazil is always—it's this original package that's moving on. It looks like it's going to go to congress very soon. So that's something we expect to give us some momentum in the Brazilian market. That's potential—that brings some potential, not necessarily for this year, but for next year.

In the US, we believe we won't see much activity as far as options confirmation this year. It's going to be more concentrated next year.

So by the combination of E1s and E2s, we again, we expect to have a book-to-bill above 1 at least, this year.

Q - Derek Spronck {BIO 17904184 <GO>}

And—thank you. And the delivery cadence for the commercial, was Q1 just a tooling ramp for the US carrier orders? And should Q2 have the full-year run rate in place or will

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there be a gradual ramp?

A - Frederico Curado {BIO 2004589 <GO>}

I thinkâ€”I don't have the preciseâ€”I think that we probably lost one or a couple of aircraft in the First Quarter. It's pretty much in line with our planning. So again, we're talking 92 to 97 airplanes in the year. So it's not particularly off the historical average. You know, First Quarter is always lower than the other quarters. We saw fundamentally, no big concern there. I think we lost maybe just oneâ€”maximum two airplanes in this quarter, which probably has already been delivered in the Second Quarter.

So again, we are confident about the range of our guidance.

Q - Derek Spronck {BIO 17904184 <GO>}

Great. And just one question, one last question if I could. Can you just comment on the FX rate and if it were to stay at current levels for the rest of the year, is that already taken into consideration with your reaffirming guidance across all your measures?

A - Jose Filippo {BIO 1726218 <GO>}

Yes, like we said in our last meeting, we used a 2.35 as one average for the year. So that's what we considered. So we understand that this could be still in place, our expectation for the exchange rate, so there's no reason for us to change it.

The First Quarter was below that, just a little bit below that. But that (does) indicate a short-term or a mid-term trend as well. So we think that it's not a moment to review that, so keeping our projections, using the exchange rate that we (mentioned).

Q - Derek Spronck {BIO 17904184 <GO>}

And would it be fair to say that roughly a 10% FX move would, for a full-year, impact margins by 100 basis points? Is that a good sensitivity to utilize?

A - Jose Filippo {BIO 1726218 <GO>}

Yes, yes. About 80 to 90; close to 100, that's OK.

Q - Derek Spronck {BIO 17904184 <GO>}

OK. Thanks very much.

Operator

Ron Epstein, Bank of America Merrill Lynch

Q - Ron Epstein {BIO 1868102 <GO>}

Good morning. Question for Fred; a question I'm frequently asked by investors looking at Embraer is how should we think about the potential gap or not a gapâ€”of deliveries

between the E1s and the E2s? So as the E2s roll into service in I guess whatâ€”2018 and beyondâ€”and what you have in terms of the order book today; how do you think about filling that?

A - Frederico Curado {BIO 2004589 <GO>}

Hi, Ron. Thank you for the question. We areâ€”I mean this is certainly a major focus of our Company. It has been for-- since we launched the E2 assembly last year. So 2014 we are, as I just-- a couple of minutes ago I just mentioned that we feel confident about our guidance. There are always some challenges, sales and finance. But as far as backlog, we look pretty good in the picture. 2015 looks good, too. 2016, at this time, being two years away, it's probably as good as it could be.

So we start to see of course, in our skyline, a softer picture more towards the second side of 2016 and 2017. So we have plenty of time to take orders and get to fill thatâ€”to fill that skyline. We believe on top of the individual campaigns of 190-195 here and there, there's always some action at option activity. We believe that probably next year, we're going to see another round of demand for the US for 175s, which fundamentally, from confirmation of existing options, they have a lot of options in our backlog. And there are a lot of 50-seaters which will retire in that market in the next several years. And there areâ€”not a lotâ€”but they're starting to have a ramp up of older 70-seaters, so especially CRJs which came earlier into the market, compared to 170.

So between the 50-seaters, which will be at end of their leases; and the first expiration of leases in the 70-seaters, I mean there will be a demand for new 76-seaters and we feel pretty well-positioned to fill that demand.

So it's as I said, we're not underestimating the challenge. But I think we are feeling as confident as we could that what we have seen in 2014 and 2015 and starting to see 2016, (like stand through)â€”and may probably even overlap with the E2, because in 2018 we have the 190 to come into the market. But the 175 E2 will not come into the market until 2020. So that demand for 76-seaters will be fulfilled with existing 175, this enhanced version, until 2020; so potentially giving us some overlap in those last two years of the decade.

Q - Ron Epstein {BIO 1868102 <GO>}

OK, great. And if I can, just one follow-on question. The E2 195 seems like a little bit of a different machine than what you guys currently offer in terms of its size, range; fuel burn. In some ways it really seems like a category killer.

What response have you had from the airlines on that airplane? And I guess specifically what I'm driving atâ€”I mean, how is it positioning against theâ€”I guess the CS100 and even if you're comfortable talking aboutâ€”I mean what's the feedback been vis-a-vis, the 8319 and the 737 and 700-800?

A - Frederico Curado {BIO 2004589 <GO>}

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Yes, Ron. You're right on. The 195 E2, with the benefit of the bigger engine, the benefit that we do not have today with the existing engine, so it's an engine with a lot of power reserve. So weâ€™and of course the benefit ofâ€™it's a disparate design of the (same). It's not just a reengineering. So with those two, let's say, flexibilities; we were able to stretch the airplane quite a bit, so we're increasing the payloads compared to the existing 195, probably more than 10%.

And given this airplane with this new wing and new power plant, a 190 and let's say an existing 190 performance, so we are indeed creating a very viable, very attractive machine for the 120 or plus, dual-class configuration.

This airplane, as far as DOC, the direct operating cost per seat, per trip for sure, but even per seat, it's going to be a lower cost than anybody else in that size in the market. So to your question; have the airlines already received that? I think they're starting to.

If you look at our order book, both ILFC and the Air Costa, they have both 190 and 195 in the same quantities, which indicates that yes, we may be creatingâ€™I'm not saying a new segmentâ€™but we'll certainly be creating the possibility of a more affordable flight on this 120-130-seat segment.

Being a stretched aircraft, it's going to have very compelling economics compared to the (dash-7), the 37-7s through the 319, and surely vis-a-vis the CS100.

Q - Ron Epstein {BIO 1868102 <GO>}

All right. Great. Thank you.

Operator

Joe Nadol, JPMorgan.

Q - Joe Nadol {BIO 3056499 <GO>}

Thanks. Good morning. First question is on the working capital build. I know some of that certainly, much of that was in commercial, just getting ready for higher deliveries later in the year. Was some of that in defense also?

A - Jose Filippo {BIO 1726218 <GO>}

Most came from commercial aviation. But we had also in defenseâ€™

A - Frederico Curado {BIO 2004589 <GO>}

Yes. We have an increase in accounts receivable on top of that, Joe.

Q - Joe Nadol {BIO 3056499 <GO>}

Yes, so is that an unbilled receivable that's built in in defense on the KC-390?

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A - Jose Filippo {BIO 1726218 <GO>}

No. It's just several programs that the general programs, not specifically there was an increase. Basically, the increase in the revenues in the First Quarter led us to have this increase in accounts receivable. That's basically tied, too. But that together with the commercial and some in these accelerations and also the buildup of the inventories of the work in process for the coming quarters.

Q - Joe Nadol {BIO 3056499 <GO>}

OK. And on the SG&A, I obviously heard the explicit guidance of about \$160 million per quarter for the rest of the year. Were there any items in Q1 that let it down to \$140 million or was that just good performance?

A - Jose Filippo {BIO 1726218 <GO>}

No. That's our guidance, actually. This is some level that we said we (shouldn't) maintain what we had in the First Quarter. Except there's something about some dollar-denominated expenses that helped it in the First Quarter, and some specific, maybe seasonality of some business that then has some expenses, especially commercial expenses that could not repeat going forward. So it was a good result for the First Quarter, but we don't expect to see this necessarily repeating in the next quarters.

Q - Joe Nadol {BIO 3056499 <GO>}

OK. And just one more. The legacy 500; we're getting ready hopefully to go here very shortly, just your latest update on that certification program and getting ready for first delivery.

A - Frederico Curado {BIO 2004589 <GO>}

Flight campaign pretty much done. We are in the phase of finalizing the reports. There is in parallel, we have the certification of the engine. It's an (inaudible) engine, but it has different thrust ratings and different fade backs and whatever differences there are there. So that's also coming in parallel. So targeted for mid-year, as we have been saying. So as far as the physical tests of the airplane, we are pretty much done.

Q - Joe Nadol {BIO 3056499 <GO>}

OK. Thank you.

A - Frederico Curado {BIO 2004589 <GO>}

We took our "we've been" now we have "one of the prototypes has a full interior, as the first I'd say, commercial specimen will be. And we are already showing the airplane a lot in air shows, attracting a lot of attention. So I would expect that our sales people, more towards the end of the year, they really start to build up some momentum in the program.

Q - Joe Nadol {BIO 3056499 <GO>}

Very good. Thanks, Fred.

Operator

Noah Poponak, Goldman Sachs.

Q - Noah Poponak {BIO 16071528 <GO>}

Hi. Good morning, everyone, or good afternoon your time. Fred, I wanted to go back to the broader business jet market question and thinking a little bit less about the actual real demand you saw in the quarter, and a little bit more what you're seeing in terms of the leading indicators you care about. And I guess there's been some reason to believe that executive management confidence is increasing, if we look at what happening in the M&A market or with capital spending.

So I justâ€”

A - Frederico Curado {BIO 2004589 <GO>}

Noah, sorryâ€”you were cut off by about 10 seconds. Could youâ€”we just heard until executive management, and we lost you.

Q - Noah Poponak {BIO 16071528 <GO>}

OK, yes. The point I'm trying to make, I guess, and the question isâ€”there's evidence of improving executive management confidence when you look at M&A activity, capital spending; some other items. And so I'm sort of curious just if you can talk about the conversations you're having with your potential corporate customers, whether or not they seem like they're feeling more confident and more ready to potentially order aircraft or if that's all irrelevant because used inventory is still too high?

A - Frederico Curado {BIO 2004589 <GO>}

It's kind of a mixed bag. Noah, you see people with a lot of cash out there. So people are justâ€”some people are just back to normal business, changing their airplanes every five years. Some are still reluctant. Many are still sayingâ€”well, you know what. I can fly my airplane for another two, three, four, five years. And in the end, if I sell my airplane used now, the inventories are high, so my costsâ€”I mean the price I can get for a used aircraft is low, so I better just keep flying what I have.

So it'sâ€”you hear this about everything. But I think as a trend, I'm particularly optimistic in the US. I think the US market is by far, the most mature market. People get it. Society understands business aviation, so there is much less psychological factors than what you see in China and Brazil and even in Europe to a certain extent.

So it'sâ€”I find it hard to give youâ€”let's say a clear answer, because we kind of hear several different conflicting stories. It depends a lot on each individual situation.

Q - Noah Poponak {BIO 16071528 <GO>}

Do you have any thoughts onâ€”so it sounds like very low prices in the used market still a hurdle, because you can buy less expensive aircraft, but also, you're not incentivized to

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upgrade because of your trade-in value. Do you have any thoughts on where used inventory, either on an absolute or percentage of the fleet, needs to be and how much better pricing needs to be before those hurdles can be overcome? Or is it pretty difficult to pin that down?

A - Frederico Curado {BIO 2004589 <GO>}

No. We can probably try to give you a more precise answer. I would say it has been single digits for sure, not what we're seeing these days. Today I think are what? 12% 10%, 11%, 12% or something. So it should be certainly on the single digits. I think historically, I prefer to ask my marketing guys and give you precise answer later. I would if I just had to make guess, now would be something like 5% or 6%.

Yes, Luciano is just helping with the graphs here. So in the good times, about 4%; 3% to 4%. And those are the good years. So now we are much higher.

A - Luciano Froes {BIO 17907241 <GO>}

And that's (inaudible); this is Luciano commenting. So the numbers that Fred highlighted there are particularly for the relatively young pre-owned aircraft that go up to 10 years of age.

A - Frederico Curado {BIO 2004589 <GO>}

Yes. And beyond that, we do not even count.

Q - Noah Poponak {BIO 16071528 <GO>}

OK. That's helpful. Then just a couple housekeeping items; did you go through what the other the negative other expense was? What caused that in the quarter?

A - Luciano Froes {BIO 17907241 <GO>}

Yes, so hi. So we've typically said previously that that line should fluctuate around mid-teens. We did have about \$13 million of non-recurring in this line during this quarter that brought it up to an additional about \$28 million total. And that was primarily related to intercompany transfers and related taxes associated with those movements. So that's why you saw that let's say increase in that line for this quarter.

Q - Noah Poponak {BIO 16071528 <GO>}

OK, great. Then on the net interest income or expense, how should we expect that to trend versus the First Quarter, through the rest of the year?

A - Jose Filippo {BIO 1726218 <GO>}

Oh, I think that we have we're probably going to an increase in terms of the expenses going forward, in the levels that we saw year, which is like just at specific moment related to some exchange rate and some specific RVG valuations in our portfolio. But basically, this is only for the First Quarter. I think that we shouldn't see that I think it was better

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than what we should expect, but without anything that could be too much, that we had last year.

Q - Noah Poponak {BIO 16071528 <GO>}

So we should look for that to go back to last year's quarterly run rate?

A - Jose Filippo {BIO 1726218 <GO>}

Correct.

Q - Noah Poponak {BIO 16071528 <GO>}

OK. Thanks very much.

Operator

Pete Skibitski, Drexel Hamilton

Q - Pete Skibitski

Hi, guys. Can you tell us what, on the gross margin decline year over year; can you tell us what the primary driver of that was? Was it commercial mix or was it something else? Was it wage rates across the firm?

A - Luciano Froes {BIO 17907241 <GO>}

Hi, Pete. Luciano speaking here. So basically on the gross margin you had primarily what we already mentioned, a little bit of a different mix in commercial aviation, more 170 and 175s representing a little bit over 60% of the deliveries in commercial. And also on the executive jet side, we had a slightly lower gross margin as well. So those I would say, were probably the main contributors of the slightly lower gross margin for the quarter.

Q - Pete Skibitski

OK, great. Then would you guys have been able to raise EBIT margin guidance had the real not strengthened since year end?

A - Luciano Froes {BIO 17907241 <GO>}

I'm sorry, Pete. Can you repeat please?

Q - Pete Skibitski

Oh sure. I was just wondering, had the real not strengthened since year end, do you think you'd be in position to have been able to raise your operating margin guidance for the full year?

A - Jose Filippo {BIO 1726218 <GO>}

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No. I mean we based our planning in an exchange rate of a 2.35 which is clearly above last year's average. So it comes upâ€”part of the sustaining for our EBIT guidance is in FX around 2.35.

Q - Pete Skibitski

OK, OK. I also wanted to askâ€”I think he mentioned somewhere that wage rates have risen 8% this year. And I just wanted to seeâ€”I assume the Selic rate rised pretty substantially in Brazil and I'm just wondering if your sense with the Selic rising so much; do you think wage inflation will maybe come down a bit heading into next year.

A - Jose Filippo {BIO 1726218 <GO>}

No. I think we'll see there is an inflationary pressure in Brazil, and we unfortunately have an economy which is still indexed. So it's almost like automaticâ€”although it's not legally automatic, but in the end it's practically automatic every year. So with inflationary pressures, there will be pressures also for wage increases.

Having said that, I mean we believe that the exchange rate must also reflect that situation. So we seeâ€”we don't see the real staying where it is today, like 2.24. We see it going back to 2.30 to 2.35 to 2.40 level. So 2.35 average for the year, in our opinion, it's conservative, or I'd say a realistic expectation.

Q - Pete Skibitski

OK. One more margin question; are you guys able to give us operating margin performance for the segments for the First Quarter.

A - Frederico Curado {BIO 2004589 <GO>}

I think we have that in ourâ€”

A - Luciano Froes {BIO 17907241 <GO>}

Yes, Pete. For commercial aviation, operating margin was about 6.2. For Bizjets it was around negative 10.7. And defense and security was around 18.7 Op margins.

Q - Pete Skibitski

OK. And the strong defense performance that was mostly volume related or was there any mix issue there?

A - Jose Filippo {BIO 1726218 <GO>}

More volume related, yes. And as the other two were volume related on the negative side as well, so we expect commercial to go up, and executive jets go significantly up as well.

Q - Pete Skibitski

OK. Just one last question on platforms. Has the Phenom 100E delivered yet, the upgrade there?

A - Frederico Curado {BIO 2004589 <GO>}

I'm not familiar with that upgrade. 100E? What we have we have the 300 and we have the 300 special version I don't think we call it E--which has different avionics, has a (Garmin 3000) avionics. But that's on the 300 only. 100; I don't think we have anything, any special version yet.

Q - Pete Skibitski

I'm sorry. OK. OK, thanks very much guys.

A - Frederico Curado {BIO 2004589 <GO>}

Nice idea; who knows?

Operator

Myles Walton, Deutsche Bank

Q - Myles Walton {BIO 6802513 <GO>}

Thanks. Good morning, still. Hoping you can first, Fred-- you mentioned the Brazilian regional package moving through Congress and then I think you also alluded to if it were to go well, it could be an upper to order activity in 2015. Could you talk a bit about the package in its specifics and also; does it open up new players in the RJ market? Or are these existing players who would just be building out their networks?

A - Frederico Curado {BIO 2004589 <GO>}

Sure, Myles. The package has fundamentally a focus in let me just start by saying about 25-30 years ago, Brazil had commercial service to some 250 airports. That's 20-25 years ago more or less. Now, we have just around 150 airports. So we are probably one of the very few, if not the only country in the world, who has reduced the (inaudible) of the commercial aviation network, instead of expanding it.

So the airports are there. So it has a lot to do with investing in updating and renew and refresh in that infrastructure. But also there is some sort of subsidy as far as supporting airlines to fly into those airports. So subsidies in the sense of elimination of tariffs and maybe some subsidy in fuel. Fuel in Brazil is awfully expensive. So the package is around that tripod, investment in infrastructure to get the infrastructure in place so the airlines can fly into those airports, and making it more affordable for the airline and would mitigate the risk of the airlines flying to those airports.

So how does that relate into the competitive scenario? I don't believe, personally I don't believe there would be many startups. I think that's going to be for example, good thing for Azul, I think. Because they have the largest, by far the largest network in Brazil as far as cities. I think that had like 115 cities. And the second guys I mean GOL and TAM,

although they are bigger, they fly to much less number of cities. So the network is already there. So Azul is prepared for that.

And I think naturally GOL and TAM will have the opportunity also to diversify their network. So I see more those three airlines strengthening their presence than really attracting new startups just for regionals. But that's a personal view.

Q - Myles Walton {BIO 6802513 <GO>}

OK. OK, and then I guess on Azul, they've made talk about going into the wide-body market and as it relates to their network using the 195s, I mean I imagine that's a positive so long as they don't look at Boeing and Airbus as kind of in-between sources of load factor driving into those hubs, wherever the wide body is going to lead from.

Do you have a sense as to Azul's plan in term of expansion of the 195 portfolio to support those wide bodies?

A - Frederico Curado {BIO 2004589 <GO>}

As we have the same vision about their long-haul service, I think that's a plus for Azul for sure and that's a plus for us. Not only because Azul would be stronger, but the (tents) should be more hub-feeding service. So that's good for us. So is Azul a potential user for more of our aircraft? I think it is. Not only E1s, but E2s. So I was just talking about the 195 E2 question that Ron raised.

It's a pretty competitive aircraft as far as capacity and cost. And so of course, I cannotâ€”we're not in a position to say Azul, will you procure this airplane? But we certainly will try hard to make a case. And havingâ€”they're needing more capacity, I mean in just a coupleâ€”just three or four years, we'll be able to have an airplane which is larger and deliver very appealing economics.

Q - Myles Walton {BIO 6802513 <GO>}

Ok. Yes, because I was just looking at their backlog, and I think the last one that they have on order (inaudible) is delivered out in 2015. So that they'd probably be making a fleeting decision in a relatively short term.

A - Frederico Curado {BIO 2004589 <GO>}

Maybe. Yes, maybe. I think 2015 is correct. But maybe.

Q - Myles Walton {BIO 6802513 <GO>}

Then one last one, a clarification; I just wanted to make sure I heard it right. You said the EBIT margins, in the sense were 18.7, Luciano? And what's the guidance for the full year EBIT margins in defense?

A - Luciano Froes {BIO 17907241 <GO>}

So the EBIT margins were 18.7, but we don't have guidance specifically by segment, Myles. So only the consolidated 9% to 9.5% EBIT margin guidance.

Q - Myles Walton {BIO 6802513 <GO>}

Is that the highest the margins have ever been in the quarter in that segment?

A - Frederico Curado {BIO 2004589 <GO>}

Probably.

A - Luciano Froes {BIO 17907241 <GO>}

Probably.

A - Jose Filippo {BIO 1726218 <GO>}

Yes, because volume was extremely high.

Q - Myles Walton {BIO 6802513 <GO>}

OK. All right, great. Thanks, guys.

Operator

Stephen Trent, Citi.

Q - Stephen Trent {BIO 5581382 <GO>}

Yes. Good day, gentlemen. and thanks very much for taking my questions. Can you hear me OK?

A - Frederico Curado {BIO 2004589 <GO>}

Yes, Stephen. How are you?

Q - Stephen Trent {BIO 5581382 <GO>}

Oh great, very well, Freddy; thank you. Just a few quick questions from me if I may. When you think about upcoming elections in Brazil this year, do you have any color as to the policy positions or at least broad policy positions of the opposition candidates with respect to defense spending?

A - Frederico Curado {BIO 2004589 <GO>}

We really don't, Steve. Specifically, so far there are no official candidates. We have like three candidates. We know pretty much who'll they will be, but they are not officially candidates yet. They have to be confirmed by their parties.

I think—the only thing I probably could comment and should comment to your question, is that there is, I think, a growing consensus about the need for fiscal discipline. How does

that affect defense in particular is hard to say. So there are two conflicting movements, or two conflicting forces. One being, of course, the need to control budget, expenses. And the other one is really to keep re-fleeting the Armed forces in Brazil. Because for decades, the investment was very low, so the need is really there, if one believes that (inaudible) needs some defense capability. There is not much room not to invest, if you know what I mean.

So but I think throughout the year, Stephen, as we probably have probably after July, after this World Cup and when the campaigns really start, we'll have much better color to share with you.

Q - Stephen Trent {BIO 5581382 <GO>}

OK. That's very helpful, Fred. And just one other quick question. When we think about the E2 and the timeline with respect to entry into service. I mean certainly in the industry, it's not like there's just two or three suppliers to these programs. There are many suppliers and everybody has to be on time. Do you have any takeaways or any view with respect to the extent that you're taking certain actions to maybe help ensure a timely entry into service of the E2, whereas it looks like all of your competitors have had at least some issues getting their planes into service in a timely manner.

A - Frederico Curado {BIO 2004589 <GO>}

Stephen, with new airplane development, it's really tricky, as everybody has suffered and demonstrated. So in the Legacy 500 we had our share of issues, as you certainly know, especially when we go to an extremely integrated aircraft, your fly-by-wire; the certification of software many times is the things that holds the process.

So we have not only the experience in the Legacy-- we have in the Legacy 500, but also we have the experience in the KC-390 which we hope to fly before the end of the year. When we combine those two experiences, with the fact that the E2â€”the only large system that is totally new to the airplane are the engines and the engines are wayâ€”they're very well as far as their certification in process. They'll be available actually ahead of the airplane. The critical path today is much more in Embraer's hands. So it's probably on the wing. It's a new wing. It's a brand new wing. Actually it's a brand new pair of wings, one for the 175 and one for both the 190 and the 195.

So weâ€”I mean we are on the safe side as far as suppliers, because the only thing really new are the engines. And the big challenge that we have as far as critical path, as far as timing, is under our control. It's our wing, our design, our fabrication. So we have a much, much better control of that.

So it's a big development. It's not just reengineering. But I have all the reasons to believe that in so far the program is actually a little bit ahead of the early stages. So we should be really able to certify the 190, too, in the first half of 2018. We don't see any major roadblocks to that.

Q - Stephen Trent {BIO 5581382 <GO>}

OK. (Spoken in foreign language)

A - Frederico Curado {BIO 2004589 <GO>}

(Spoken in foreign language)

Q - Stephen Trent {BIO 5581382 <GO>}

(Spoken in foreign language)

Operator

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

A - Frederico Curado {BIO 2004589 <GO>}

Thank you for holding on with us and look forward to talking to you three months from now. All the best and a happy Labor Day, Labor Day in Brazil. It's not the Labor Day in the US. And in Europe as well. Thank you.

Operator

That does conclude Embraer's audio conference for today. Thank you very much for your participation. Have a good day.

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