

Q2 2015 Earnings Call

Company Participants

- Eduardo S. Couto, Director of Investor Relations, M&A and New Businesses
- Frederico F. Curado, President & Chief Executive Officer
- José Antônio de Almeida Filippo, Chief Financial Officer and IRO

Other Participants

- Alexandre P. Falcao, Analyst
- Cai von Rumohr, Analyst
- George Ferguson, Senior Analyst Aerospace/Defense & Airline Research
- Myles Alexander Walton, Analyst
- Noah Poponak, Analyst
- Peter John Skibitski, Analyst
- Ronald J. Epstein, Analyst
- Turan Quettawala, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen, and welcome to the audio conference call that will review Embraer's Second Quarter 2015 Results. Thank you for standing by. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions to participate will be given at that time. As a reminder, this conference is being recorded and webcasted at ri.embraer.com.br.

This conference call includes forward-looking statements or statements about events or circumstances, which have not occurred. Embraer has based these forward-looking statements largely on its current expectations and projections about future events and financial trends affecting the business and its future financial performance. These forward-looking statements are subject to risks, uncertainties, and assumptions including, among other things, general economic, political, and business conditions in Brazil and in other markets where the company is present. The words believes, may, will, estimates, continues, anticipates, intends, expects, and similar words are intended to identify forward-looking statements.

Embraer undertakes no obligations to update publicly or revise any forward-looking statements because of new information, future events, or other factors. In light of these risks and uncertainties, 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. José Filipo, Chief Financial Officer and IRO; Mr. Eduardo Couto, Director of Investor Relations.

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

José Antônio de Almeida Filipo

Okay. Thank you. Good morning and thanks, everybody, for joining our second quarter 2015 earnings call conference. As usual, we'll go through the presentation and then we'll be ready for the questions after that. So going to the presentation then, we'll start on page 3, the financial highlights for the second quarter. We reached our record order backlog of \$22.9 billion in the end of the second quarter. We had a positive free cash flow of \$73 million in the second quarter. Also reported operating income of \$102 million, net income of \$129 million, and earnings per share of \$0.7096 in the second quarter, almost \$0.71.

Also, an important event in the quarter was the issuance of \$1 billion notes due in 2025 with a coupon of 5.05% for the year, which was important in terms of meeting our requirements in terms of capital structure and demands in terms of investment going forward. We finalized the financial results - sorry, the financial highlights with important information about - that we just released, 2015 guidance adjustment, especially related to the Defense business revenue revision, but reiterating our EBIT and EBITDA range estimate. We're going to be elaborating more about that during the presentation.

Next page, page 4, in relation to the Commercial Aviation highlights. We delivered 27 E-Jets in the second quarter, accumulated of 47 E-Jets this year, with 102 firm orders announced in the quarter in line with the 124 firm orders year-to-date.

In relation to commercial activities, we've recently announced several orders including the Azul firm order for 30 E-Jets; Tianjin Airlines order for 20 and two, split between the current generation and the E2 model; also eight E175 for SkyWest that will operate the Alaska Airlines. Aircastle firm order for 25 E-Jets new generation; Colorful Guizhou Airlines firm order for seven E190; and the 10 E175 for United Airlines. Finalizing Commercial Aviation highlights, regarding the E2 program development, we had an important milestone in this quarter, which is the start of the assembly of the first prototype of the E190-E2.

Moving to next page, regarding Executive business highlights, the delivery of 33 executive jets in the quarter, split by 26 lights and 7 large, accumulated of 45 in the year. An important achievement of our investment (05:33) activity in our Florida facility was the delivery of the Phenom number 100, assembling at the Melbourne facility.

FINAL

Bloomberg Transcript

FINAL

In terms of new orders, we announced the firm order of four Phenom 100 to Etihad Flight College in this quarter. And finalizing Executive Jets, in relation to the development of the Legacy 500 and Legacy 450 program, we had another important achievement for Legacy 500, which was the four new world speed record. Regarding the Legacy 450 program, we also remained on track and entry into service is scheduled for the last quarter of this year.

Now moving to next page, page six, in terms of Defense & Security highlights, starting with commercial announcements in the second quarter, which was the sale of five Super Tucanos to the Ghana Air Force and six Super Tucanos to the Republic of Mali. And regarding the LAS program, we continued to divest with the delivery of three aircraft in this quarter, which now returns to eight aircraft to-date. Also, in terms of the modernization program for the Brazilian Navy, we delivered the first AF-1B jet fighter to that customer. Finalizing the Defense highlights, in relation to the KC-390 program, we will start the flight test campaign now in the third quarter of this year and the progress for a program update where we expected now certification for the second half of 2017 and the entry into service in the first half of 2018.

With that, we conclude the highlights and getting to the financial results. Next page, actually page eight. Before we get into the numbers for the quarter, we like to inform about our guidance revision. We are maintaining our EBIT and EBITDA estimates. But in order to reflect primarily the devaluation of the Brazilian real, we are reducing our Defense & Security business revenues range for 2015. In a consolidated basis, this reduction will also impact, of course, the total revenues of the company. But this combined with the EBIT and EBITDA maintenance range, we will turn into a higher EBIT and EBITDA margin. With that, the new outlook would be, as we have in page eight, for net revenues consolidated, the new outlook would be from \$5.8 billion to \$6.3 billion, from \$6.1 billion to \$6.6 billion.

In terms of Defense revenues, the outlook for 2015 from \$0.8 billion to \$0.95 billion revenue from \$1.1 billion to \$1.25 billion. In terms of EBIT, remain in the range of \$490 million to \$560 million, but now the range increased to 8.4% to 8.9% - sorry, to 8.5% to 9% from 8% to 8.5%. And in terms of EBITDA, remain in the range from \$730 million to \$860 million with a new EBIT margin from 12.6% to 13.6%. The other estimates for investment and free cash flow remains unchanged.

Going on next page, page nine. In terms of financial results, now showing our firm order backlog. We're reaching the end of the second quarter, as we mentioned before, \$22.9 billion. This is our all-time high information.

Next page, page 10, in terms of aircraft deliveries. In the left side, we delivered 27 aircraft in Commercial Aviation in the second quarter, and we have a total of 47 aircraft accumulated to-date, in the year. In terms of Executive Jets, we delivered 33 aircraft in the second quarter, broken by 26 light jets and nine large jets and accumulated of 45 aircraft in the year.

FINAL

In terms of our outlook, we take the opportunity to confirm our expectation for 2015, which is a range of 95 to 100 E-Jets, 35 to 400 (sic) [40] executive large jets, and 80 to 90 executive light jets.

Next page, page 11, in terms of revenues consolidated and by business unit, we had, in the second quarter, the consolidated of \$1.5 billion in terms of revenue, which accounts now for \$2.57 billion accumulated in the year. In terms of Commercial Aviation, \$883 million in the second quarter, accumulated of \$1.54 billion. Executive Jets, \$404 million in the second quarter, accumulated of \$0.57 billion. And in Defense, \$216 million, accumulated of \$0.43 billion in the year. In this page, we already showed the adjusted Defense revenues and consolidated revenue estimate as indicated. Defense now from \$0.8 billion to \$0.95 billion and consolidated now from \$5.8 billion to \$6.3 billion.

Continuing the presentation, next page, page 12. The consolidated net revenues in Brazilian reals and U.S. dollars, (12:12) almost \$2.6 billion accumulated in dollar terms turns into BRL 7.7 billion in terms of revenues. For 2015, the outlook indicates the range of \$5.8 billion to \$6.3 billion, already reflection on the new guidance as we said before.

Going forward, page 13, in relation to SG&A expenses, we had \$147 million SG&A expenses in the second quarter, split by \$47 million of general and administrative expenses, and \$100 million for selling expenses. This represents a decline when compared to the same quarter of last year, reflecting our cost control efforts (13:05) coupled with more favorable exchange rates. In terms of percentage of revenues, we are in line with the previous year of 9.7% in 2015 second quarter compared to 9.5% in the second quarter of 2014.

So going next page, page 14. As far as EBIT, we had a total of \$102 million in the second quarter with a margin of 6.8%. In terms of year-to-date figures, the total EBIT reached \$182 million with a 7.1% margin. For 2015, we are maintaining our guidance range for \$490 million to \$560 million, but increasing our margins range to 8.5% to 9% as I said before.

Next page, in terms of EBITDA, we reported a total of \$178 million in the second quarter with an 11.7% margin, returning to accumulated in terms of EBITDA for 2015 of \$327 million with a margin of 12.7%. In relation to the outlook, as we said, we are maintaining our expectations for the range from \$730 million to \$860 million, but increasing the margin to 12.6% to 13.6% for the whole year.

Next page, in terms of our net income, we reported net profit of \$129 million in the second quarter with a margin of 8.5% net margin and accumulated of \$68 million in 2015. In terms of Brazilian reals, a net profit of BRL 400 million in the second quarter with accumulated of BRL 203 million in the year.

Going next page, as far as free cash flow generation, we had a positive free cash flow of \$73 million in the second quarter with \$245 million positive from operating activities. This was primarily due to the positive EBITDA coupled with better figures for our working capital requirements, especially lower inventories and increased investment from

customers. As we've mentioned before, we are maintaining our outlook for the year, which represents less than the consumption of \$100 million in terms of free cash flow.

Next page in relation to investments, page 18, we had a total investments in the first six months of \$196 million, broken by \$94 million investment in CapEx, \$84 million in development, and \$18 million in research. We expect to see the higher numbers in the second half for development, the CapEx, primarily due to the development schedule of the E2 program. At this point, we are keeping our estimate of \$650 million for 2015.

Next page, page 19, finalizing the presentation before we go to Q&A session. Our capital structure showed an improvement in our net debt position, but also a debt profile improvement reaching the average terms of 6.5 years coming from 5.3 years in the first quarter, mostly of course, reflected by consequence of the issuing of the 10-year bonds that we did recently last month, which brought us to a better profile in terms of being able to meet our investment requirement and also in terms of cost. This was important. In relation to net debt, we improved our first quarter figures basically because of the positive cash generation that we have in the second quarter with now having a figure of \$511 million in terms of net debt coming from \$581 in the end of the first quarter.

With that, we close this part of the presentation. And now, we're ready to open for questions. Thank you.

Q&A

Operator

Thank you. And our first question comes from Noah Poponak from Goldman Sachs. Your line is now open. Please go ahead.

Q - Noah Poponak {BIO 16071528 <GO>}

Hi. Good morning, everyone.

A - José Antônio de Almeida Filippo

Good morning.

Q - Noah Poponak {BIO 16071528 <GO>}

Did you give us a new USD to BRL exchange rate in the revised EBIT margin range?

A - José Antônio de Almeida Filippo

Yeah, go ahead.

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

Hi, Noah. It's Eduardo. We are assuming now a BRL of BRL 3.20 for the second half, which would imply an average BRL for the year of around BRL 3.10 from BRL 2.80 before, right?

So just to remind you.

Q - Noah Poponak {BIO 16071528 <GO>}

Okay. Great. With the used aircraft value impairments, can you give us a little bit more detail on where those occurred?

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

Yeah, go ahead.

A - José Antônio de Almeida Filippo

Yeah. Okay. This is – as we have – we follow the procedure that we'll be doing in terms of the calculation. We have the process of the appraisals that we do an average. And we do evaluate this every quarter. In terms of the financials, you saw that reflected in other operating expenses, that typically as you know, we work on the new teams there, and we have a little bit more like \$27 million in this quarter that primarily reflect that the impact in that revision was the calculation the way we report.

Q - Noah Poponak {BIO 16071528 <GO>}

Yeah. I guess, I meant, which aircraft type and sort of what are the implications of the related end market that that's still occurring in those aircraft type?

A - José Antônio de Almeida Filippo

It's more the 145 fleets.

Q - Noah Poponak {BIO 16071528 <GO>}

Okay. So it was not anything in the business jet market?

A - Frederico F. Curado {BIO 2004589 <GO>}

No. No. No. It's commercial jets and more concentrated on 145.

Q - Noah Poponak {BIO 16071528 <GO>}

Got it. And then just last one from me, is there any ability to – maybe it's a little too early, but to start to discuss how we should think about the progression of Defense & Security segment growth beyond 2015 if we were to assume the exchange rates didn't change? Obviously that's impacting revenues a lot. If we were to assume that doesn't change, how should we think about the ability for this segment to grow or not next year?

A - Frederico F. Curado {BIO 2004589 <GO>}

Yeah. Noah, at this point, I don't see 2016 much better than 2015. So 2015 is the year of adjustment. So of course, we work hard as everybody else in this adjustment effort. At this stage of course, Noah, without knowing what is the planned budget for next year would be, just guessing, flattish probably would be a nice guess at this stage. But again, as we

go towards the end of the year, we would be able to give kind of more educated guess as we see the budget proposal to be sent to Congress by the end of the year.

Having said that, we are also working on the exports side. So we have several campaigns going now for the Super Tucano. We have not - despite this little reprogramming on the KC-390, which, by the way, has also, let's say, a little bit positive for us in the sense of giving us a little bit of slack, which was a very aggressive schedule. But the campaigns are still going on. So the interest in the aircraft is there. So we're also working on the exports side, so it's not only the Brazil's defense budget.

Q - Noah Poponak {BIO 16071528 <GO>}

Got it. Okay. Thanks very much.

A - Frederico F. Curado {BIO 2004589 <GO>}

Thank you.

Operator

Thank you. And your next question comes from Ron Epstein from Bank of America. Your line is now open. Please go ahead.

Q - Ronald J. Epstein {BIO 4430430 <GO>}

Hey, guys. Good morning, guys.

A - Frederico F. Curado {BIO 2004589 <GO>}

Good morning.

Q - Ronald J. Epstein {BIO 4430430 <GO>}

On the Defense side in the quarter, it looks like margins are down a lot. If you could just kind of walk through why that happened? And then it looks like the receivables from the Brazilian government were up, almost BRL 200 million, and how we should think about how you are thinking about those receivables being recovered as we go into next year?

A - Frederico F. Curado {BIO 2004589 <GO>}

Yes. Okay. So I'm going to answer the receivables and then you talk about the margins. Receivables. They do go up more precisely, Ron. I think it was something in the rate of \$90 million to \$100 million. I mean we have been reducing our cost and reducing the allocation of our resources to programs. But of course, the speed is different, the speed of the payments. The reduction in payments and the speed that we do expense. But we are absolutely addressing as we said last quarter our allocation of resources, not to finance the program any further. Having said that, this outstanding balance that we have in accounts receivable, this is part of this reprogramming. We're renegotiating our amendment as we speak, to, number one, reprogram and smooth out a little bit the development and fundamentally postpone it a year in the beginning of the serialization of

the program. And also this amendment shall reflect the cost associated to this reduction and this resumption and absorption of this accounts receivable. So not in 2015. We do not expect any reduction. We expect to keep it at that level. We do expect to start recovering that from 2016 on.

A - José Antônio de Almeida Filippo

And, Ron, in terms of the margins as we indicated there, mostly it comes from the cost base revision that we'll have to do. Defense programs, typically they are likely percent of our completion type of contract, and you have to do revisions as we have in terms of margin impact. Because of the exchange variation, this had to be done. It was about like \$25 million this year the FX impact on those programs, \$20 million was before actually. So this is primarily the reason for the margins, which we understand it's more in the second quarter. If we exclude that impact, it will be a positive margin. So that's basically the explanation for the impact margin that you saw there in the Defense business.

Q - Ronald J. Epstein {BIO 4430430 <GO>}

Okay. Great. And then maybe one last question, if I may. How is the business jet business going for you guys, particularly in North America. We've heard some different commentary in the last week from different companies as they reported that biz jets are good, biz jets are bad, just kind of all over the place. So I was just kind of curious how you guys see the end market now and in particular how it's going for Embraer in the U.S.?

A - Frederico F. Curado {BIO 2004589 <GO>}

(25:53) Ron. It's not good, not bad. It's okay. It's similar to what it has been in the last several months. U.S. remains strong. So we see activity in the U.S. We have been able to sell small-sized cabins, particularly the 300 and the 500. There has been a lot of interest in the 500. So at this stage, sitting now at the end of second quarter, we are a little bit better than what we were last year comparing. That does not mean that second half is going to be an easy semester. But we are a little bit better than we were a year ago.

So around the world, not much activity. South America, very weak. China also has not recovered. The U.S. is where the activity is. And the rest of the world is not great. So this is pretty much the picture that we have seen in the last several months.

Q - Ronald J. Epstein {BIO 4430430 <GO>}

Okay. Great. Thank you so much.

Operator

Thank you. And your next question comes from Alexandre Falcao from HSBC. Your line is now open. Please go ahead.

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

Good morning. Just wanted to understand what's the coming quarters regarding Defense, guided lot of adjustments. Are we going to see more of those going forward

already in sort of kitchen sink, everything that we should see in Defense? That's the first question. The second question is, if you look at the new FX or the new FX assumptions, you actually didn't change the actual guidance. It's more of FX thing. Is that a correct reading for the change in guidance? Thank you.

A - José Antônio de Almeida Filippo

On Defense, I mean we believe that once now the reduction and the cuts in the budget have been defined, I mean we can say that we would not expect any further reduction. So I think there is a commitment from the government side to whatever level they have defined. So the only impact as far as activities, I think from now on, we'll be adjusted to this new ability of the customer to pay for that.

The only thing which can impact margins further is the continue devaluation of the real. The real keeps going down and significantly that can affect revenues. Again, we are factoring all foreign accounting, so that we have turned into potential headwinds in Defense. But that same effect is going to cause a positive effect on commercial jets and business jets, where the real costs would be lower.

So as far as the company, I mean we are pretty much, I think, hedged naturally further. And as Eduardo said, we are forecasting a BRL 3.20 FX for the next semester - for the second half. It may be higher because it's now at BRL 3.30, BRL 3.32. But again, we believe with this reduction in the guidance of Defense by \$300 million, we had some margins to accommodate. Even if it was a little bit beyond \$320 million, it would be okay.

The second part of the question was?

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

Was that the computation (29:36), I think I already mentioned because (29:37).

A - José Antônio de Almeida Filippo

Yeah. Same effect that is negative, if we're talking about the FX impact, this has impacted the Defense business. We have a positive impact in the other businesses. That's why we kept the EBIT and EBITDA range. And that with the lower revenues, it increased the projection for the margin. That's basically how we assess this.

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

Okay. So, just - so the devaluation in FX is net-neutral for you in terms of margins. That's the understanding here.

A - Frederico F. Curado {BIO 2004589 <GO>}

It's positive in the - it's positive - overall, it's positive for the company. And that's why we were able to - that's why we were able to even with a lower revenue in the company now we can actually increase the margins. And this comes exactly from the devaluation, which affects positively the lower costs in reais that we have in the company.

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

And, excuse me, to make sure you understand the most (30:41) question was that because Defense, when you do a revision on the cost on the percentage of the completion of contract, you recognize that in one moment, but the benefit that we mentioned, the other business, they come with the manufacturing and going through the inventories and delivering the upgrades. So there's a timing maybe difference on the positive and the negative impact sometimes.

A - Frederico F. Curado {BIO 2004589 <GO>}

And just to complement, keep in mind that Defense is about 20% of our overall business and 80% is the other two businesses. So that's also another element.

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

Yeah. And if I may, just to clarify one thing. Was KC the only program revised here or Sisfron and the others were also impacted?

A - Frederico F. Curado {BIO 2004589 <GO>}

Good question, Alexandre. We have - on the Sisfron satellite, I would say the change were negligible, so pretty much preserved. Satellites - or the launching service is already hired for the second half of next year with Ariane. So at this stage, a delay in the program will certainly delay the launch of the satellite, and Sisfron is moving on as well. The modernization programs, several - there would be a reduction in scope and also some reprogramming, but those are minor programs, so the impact is not very material for us.

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

Thank you so much.

Operator

Thank you. And your next question comes from Myles Walton from Deutsche Bank. Your line is now open, please go ahead.

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

Thanks. Good morning. Fred, you made the comment that things in the executive aviation were a bit better than where you were a year ago. Just wanted to clarify if that was deliveries to-date, what about kind of your order uptake and intake, and maybe some color on book-to-bill in the quarter?

A - Frederico F. Curado {BIO 2004589 <GO>}

Yeah. I meant more looking forward, not backwards. So I'm not sure we do - did we talk about - we really don't, right? But I mean, just to give a qualitative answer, Myles, we - I mean, we're not - we still have to sell a few airplanes to meet our guidance for 2015. It's not that the skyline is already full, but in that aspect, this is what I meant - what I meant that we feel a little bit better now than we felt about a year ago. So, in other words, what

I'm saying is that so we feel comfortable about – at this stage, about fulfilling our delivery guidance for both small cabin and large cabin. There's a lot of activity in the 500, and that's helping us towards that end.

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

Okay. And then, Fred, I know you don't want to comment specifically on a specific customer in the regional jet category, but Republic is 20% of your annual E-Jet deliveries over the next few years and they've gone through a couple of things right now. As you read it, how do you evaluate that situation? Do you see any risk behind it? Is it kind of not going to encumber their ability or desire to take the 175 over the next few years?

A - Frederico F. Curado {BIO 2004589 <GO>}

At this stage, Myles, we're – I mean, we've not seen any change to our plan. The airplanes are contracted. Financing is in place. And so, at least, me, I have not heard anything from the airline. In the end, we are – at least as I speak for myself I expect that common sense will prevail. And ultimately, we'd have to think that those airplanes are not speculative. Those airplanes will have a clear address. And they'll be flown by Republic's partners. And so, they are in the fleet plans not only Republic, the fleet plans of United and American and Alaska – not Alaska, and American.

And so, I mean, as I think eventually a solution will come out. So, at this stage, we're not busy. I think we have something between 10 and 15 deliveries to go this year. Most of their – most of those airplanes are way down into production. So I do not anticipate any impact this year. And next year, you're probably right. They'd be 20-plus airplanes to be delivered. So, unless there is major problem with Republic, which again I think common sense will prevail, we may have an impact. We don't know it now. But what gives me really good comfort is that those airplanes, they are committed for the major airlines to replace over 56 jets. And so, I think that's the underlying warranty that we have that this thing will happen.

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

Okay. Thanks, Fred

A - Frederico F. Curado {BIO 2004589 <GO>}

Thank you.

Operator

Thank you. And your next question comes from Cai von Rumohr from Cowen & Company. Your line is now open. Please go ahead.

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

Yes. Thank you very much. So, could you give us – tell us where your operating margin for commercial aviation and executive jets was in the second quarter and approximately where you expect it to be for the year?

FINAL

A - Frederico F. Curado {BIO 2004589 <GO>}

Hello, Cai. Yes. Sure. Commercial jets, we achieved 12.8% of operating margin. Business jets was 6.5% and of course the Defense where - which it is what brought us down because we register it minus 20.3% in the Defense business. So, for the year, what we will see is that probably the commercial jets helping us on the upper side to keep this 8.5% to 9% range. Business jet is improving because there's much more volume in the second semester than the first. And Defense, we hope to be significantly better because the major impact of both reduction in revenues and the FX's sharp move we already captured in the first half. So there's more or less logic going forward.

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

So, shouldn't you see a good uptick with the greater volume in biz jets and the fact that you have a more favorable real and the fact that you have kind of an inventory flow through delay? Shouldn't we see a nice lift, particularly in both of those commercial businesses sequentially as we go?

A - Frederico F. Curado {BIO 2004589 <GO>}

On commercial jets, maybe not so much because we had relatively good mix in the first half. We had some good deliveries as far as margins in the first half. So, on the business jets, yes. We've seen nice is a very subjective way to see it, but some upside. Yes. We have indicated towards the end of the year that when we did the guidance six months ago, we said, well, everybody should be around that same average of 3%, (38:38) 3.5% plus or more minus 1%, 1.5%. So what we see now is that commercial jets will be on the upper side probably beyond the company average. Commercial jets will be coming pretty close to the company guidance and Defense will be a detrimental factor to that consolidated figures.

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

Got it. And then, so if I look at your Defense revenue revision, it's about 30% and it looks like FX is maybe half of that, so that there was some flip even on a constant currency basis. Can you tell us, in terms of your program adjustment, how much of that was execution related versus currency related?

A - Frederico F. Curado {BIO 2004589 <GO>}

I think you got it right, Cai. I don't have the precise numbers here, but it's probably something like 50/50, 50% of it probably is currency, 50% probably is activity.

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

Got it. And while next year, I mean, is a long way away, certainly the margin profile of the FX tailwind really helps you in the second half with both of your commercial businesses. Assuming the real is stable, we should get some nice carryover next year. And because you mark-to-market immediately on the government side, I mean barring further execution issues, shouldn't - the Defense number, which looks like it's going to be modest at best this year, should be a better number next year. So, all of this bodes fairly well for next year. Is that a reasonable thought?

Bloomberg Transcript

FINAL

A - Frederico F. Curado {BIO 2004589 <GO>}

Yes. I think it is a reasonable thought. Of course, with the benefit of six more months, we would be able to confirm or not or partially confirm that line of thought. But with the solidness, we are – the skyline on the commercial jets is very, very strong for next year. As far as when I say very strong, very strong towards maintaining the current levels that we have today. So, we have been saying consistently that we see a stable outflow in the next several years until the E2 comes into the market. So, we are strongly well positioned towards that end.

Business jets is a continuous challenge, but again, we have a new product which has received a tremendous acceptance in the market, that's the Legacy 500. And Defense, yeah, of course, we're going to adjust our cost base. We do not expect the real to keep – this year it's devaluated 50%. So, this can't keep going like this forever. So, that may result in a better future. But of course, like you said, Cai, we have to wait some more time to be able to put some – to nail that to numbers.

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

Thank you very much.

Operator

Thank you. And your next question comes from Turan Quettawala from Scotiabank. Your line is now open, please go ahead.

Q - Turan Quettawala {BIO 6362141 <GO>}

Yes. Good morning. I'm sorry if I missed that, but could you provide a clean Defense margin? Was it – did you say it was a \$25 million kind of revision in this quarter?

A - José Antônio de Almeida Filippo

That's right. Yeah. Correct.

Q - Turan Quettawala {BIO 6362141 <GO>}

Okay. And this is in addition to the \$30 million that you had last quarter. Is that right?

A - José Antônio de Almeida Filippo

Yes, correct.

Q - Turan Quettawala {BIO 6362141 <GO>}

Okay. And I'm sorry if I'm repeating stuff here, but did you – and I guess it should have – now this pretty much flushed through. Assuming the real stays constant, is that the right way to think about this?

A - José Antônio de Almeida Filippo

Bloomberg Transcript

Yeah. So, it shouldn't have an impact. If the real remains in the level that we use for the revaluation of the contract as we did. It shouldn't be impact. Of course, this is something that we have still to, for example, use as we mentioned the BRL 3.2, which is very close to the market today. So, at this level, a little bit higher today, but in this level, we should expect no further impact coming from this type revision in terms of the contract.

Q - Turan Quettawala {BIO 6362141 <GO>}

Great. And I guess, Fred, maybe one more question in terms of the Defense business. Do you think there's a risk that the government sort of starts to use your balance sheet to develop the KC-390?

A - Frederico F. Curado {BIO 2004589 <GO>}

Not beyond what it has already been used. We are carrying some \$350 million, \$370 million in accounts receivables. And, I mean, this is it. So, we are - part of our amendment discussions in the several different programs, but in particular in the KC-390, which is by far the largest program that we have, is the reprogramming both development and serialization and the recovery of those accounts receivables and of course the cost of the impact of those reprogrammings. So I do not expect 2016 to be much better than 2015. What we do not expect is new surprises like what we had this year.

Q - Turan Quettawala {BIO 6362141 <GO>}

Okay. Great. And, I mean, the commercial margin is really strong here, obviously. Is there really - I mean is there really room to raise that next year? It seems unlikely though, right, that this - considering it's so high already?

A - Frederico F. Curado {BIO 2004589 <GO>}

So, it's much more market-driven than industrially-driven. So at this stage we feel good about saying that we have not reduced the level of activity and the quality of our revenues and results. Probably too premature to talk about the upside. But if there is demand is there are several campaigns going on. So if the demand is there, we have the industrial capability to react. At this stage, I think it's premature to assume that.

Q - Turan Quettawala {BIO 6362141 <GO>}

That's very helpful. Thank you.

Operator

Thank you. And your next question comes from Felipe Yazbek from Verde Asset. Your line is now open. Please go ahead. Please check your mute button.

A - Frederico F. Curado {BIO 2004589 <GO>}

Probably left.

Operator

Thank you. And we'll move to the next question. Our next question comes from George Ferguson from Bloomberg Intelligence. Your line is now open. Please go ahead.

Q - George Ferguson {BIO 5297518 <GO>}

Thank you and good morning. A question for you on the exposure to some of the oil-related economies with business jets. Can you help me understand the demand in those regions? Do you have less exposure given the typical size of your business jet that you're sort of more concentrated in the smaller and medium size? Or was there a fair amount of demand in sort of Russia and Middle East for those kind of airplanes? And so will continued weakness in oil prices have an effect on selling those airplanes?

A - Frederico F. Curado {BIO 2004589 <GO>}

No those are markets which are important. We have important footprints in both Middle East and Russia. But we have not expected strong demand from those regions in 2015 anyway. So the answer is no. Most of our demand is expected to come from the United States. So not - no worse impact than what has already been planned.

Q - George Ferguson {BIO 5297518 <GO>}

Got it. Okay. And one more question on sort of the currency effect. Although you do say most of it's U.S., and so clearly when you're a U.S. buyer buying a biz jet in dollars, there's no issue with currency. But in some of your other currencies that have weakened, how much of an effect - or can you give me a sense for the overall effect on a biz jet sale when a soft local currency has to be converted into dollars to buy the airplane? I mean, you get a benefit from real weakness, but isn't it more painful for the customer to buy the airplane because of the weakness in their local currency?

A - Frederico F. Curado {BIO 2004589 <GO>}

You mean a customer located in Brazil or abroad?

Q - George Ferguson {BIO 5297518 <GO>}

Brazil or Russia, right. So if you're buying an airplane in dollars you had to covert RUB 60 to \$1 dollar, which is today, compared to RUB 30 a year ago, (48:00) softness - go ahead, sorry.

A - Frederico F. Curado {BIO 2004589 <GO>}

Yeah, yeah. It does. I mean, again, it's already priced in, in the sense that our planning, we did not expect - we did plan for a much lower demand in those markets, because of several factors including devaluation of the currency. The airline - I mean the business jets and the industry is totally denominated in U.S. dollars around the world.

So, yeah, it is more difficult for Brazilians, for Russians, for other developing country customers to buy - they became more expensive. But I think that those customers they never think about their local currency anyway. So they think about dollars. So what has happened is that their ability to have those dollars have diminished.

Q - George Ferguson {BIO 5297518 <GO>}

Okay. Thank you.

Operator

Thank you. And your next question comes from Pete Skibitski from Drexel Hamilton. Your line is now open. Please go ahead.

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

Good morning, guys. I apologize if some of these were asked. I got a little bit. But on the KC-390 delay, you're going to be testing for a few years now. Should we think that revenue from the KC-390 is sort of on downward glide path the next few years, or is it more stable because of the percentage of completion?

A - Frederico F. Curado {BIO 2004589 <GO>}

I think the best way to put it, what I would think would be a shift to the right of a year. So we are fundamentally pushing everything about a year to the right. I think that's the best way to think about it.

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

Okay. So revenue decline is because same revenue shifted over a longer time period?

A - José Antônio de Almeida Filippo

Yeah. Well, let's separate. We have the revenues coming from the development contracts which would end by end of next year. Now, that'd be another year. So, there'll be, of course, a reprogramming there. But I would say, the real stream of revenue coming from the aircraft in production, which was planned to start in the first half of 2017. Now, it's first half of 2018. So that is the year that I mentioned that we should - that there's a shift right of about 12 months as far as the whole, let's say, production aircraft or cash flow.

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

Okay. I think I understand now. And then, when do you guys expect a second phase of Sisfron to be awarded?

A - Frederico F. Curado {BIO 2004589 <GO>}

It's hard to tell at this stage. Probably not this year. Maybe next year would be the good guess. But as you may imagine, things are a little bit fuzzy here as far as what's next on the budget of the Brazilian government.

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

Okay. Understood. Yeah. And then just last question, is the Legacy 450 on track to deliver in the fourth quarter?

FINAL

Bloomberg Transcript

A - Frederico F. Curado {BIO 2004589 <GO>}

Absolutely. Absolutely on track.

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

Got it. Thank you so much.

A - Frederico F. Curado {BIO 2004589 <GO>}

Thank you.

Operator

Thank you. And we have a follow-up from Noah Poponak from Goldman Sachs. Your line is now open. Please go ahead.

Q - Noah Poponak {BIO 16071528 <GO>}

Fred, you sound pretty positive when talking about your effort to sell the new Legacys out of the executive segment. Just wondering if you could maybe talk about that a little more, is there a strength - new strength in that segment of the market? Or do you feel like you're doing better than your competitors that also have new aircraft in that segment of the market? And if it is that, can you maybe talk about which specifications you have in your aircraft in particular that customers really like?

A - Frederico F. Curado {BIO 2004589 <GO>}

Sure, Noah. So you got the first and the last question. So that's a full circle. And thanks for the question because it helps us to clarify if my optimism comes from the product itself. The Legacy 500 is indeed, without - no arrogance, but the most modern airplane out there in the business jet arena, especially in the mid-carrying arena.

So going forward - so the specifications, the features, they are comfort, silence, the fly-by-wire. It has tangible benefits for the passengers such as comfort, such as better way to handle turbulence and just the fact that it's something with a state-of-the-art technology. This, of course, also has an appeal with that kind of a sophisticated customer. We have broke grounds of the expansion of our facility in Melbourne for the Legacy 450 and Legacy 500. So we're producing those airplanes now in (53:13). But from the end of next year on, you have the second line in Melbourne. So we are optimistic about those two products. And remember the Legacy 450 will join its brother, sibling by the end of this year.

Q - Noah Poponak {BIO 16071528 <GO>}

Okay. And what's the new blended interest expense rate we should be using and rate on cash or interest income we should be using on the P&L?

A - Frederico F. Curado {BIO 2004589 <GO>}

Just a second. In terms of the real cost, it's from 6.12% to 6.24% as of interest grows here. In terms of dollars – the previous page. It declined from 5.56% to 5.25%.

Q - Noah Poponak {BIO 16071528 <GO>}

I'm sorry. What is that you're referring to?

A - Frederico F. Curado {BIO 2004589 <GO>}

This is the dollar-denominated debt. (54:38), right?

Q - Noah Poponak {BIO 16071528 <GO>}

Yeah. So my question is...

A - Frederico F. Curado {BIO 2004589 <GO>}

The blended rate that's U.S. dollar related comes from 5.56% down to 5.25%. And the indebtedness denominated in real rose from 6.12% to 6.24%.

Q - Noah Poponak {BIO 16071528 <GO>}

Okay.

A - Frederico F. Curado {BIO 2004589 <GO>}

Does that answer your question?

Q - Noah Poponak {BIO 16071528 <GO>}

I think so. But I'll take a look and follow up if it doesn't.

A - Frederico F. Curado {BIO 2004589 <GO>}

Yeah, well, it does have – you do the calculation, then we can check with you if that's what you want.

Q - Noah Poponak {BIO 16071528 <GO>}

Sure. Okay. Thanks a lot.

A - Frederico F. Curado {BIO 2004589 <GO>}

Thank you, Noah.

Operator

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

FINAL

Bloomberg Transcript

FINAL

This transcript may not be 100 percent accurate and may contain misspellings and other inaccuracies. This transcript is provided "as is", without express or implied warranties of any kind. Bloomberg retains all rights to this transcript and provides it solely for your personal, non-commercial use. Bloomberg, its suppliers and third-party agents shall have no liability for errors in this transcript or for lost profits, losses, or direct, indirect, incidental, consequential, special or punitive damages in connection with the furnishing, performance or use of such transcript. Neither the information nor any opinion expressed in this transcript constitutes a solicitation of the purchase or sale of securities or commodities. Any opinion expressed in the transcript does not necessarily reflect the views of Bloomberg LP. © COPYRIGHT 2022, BLOOMBERG LP. All rights reserved. Any reproduction, redistribution or retransmission is expressly prohibited.

Bloomberg Transcript