

## Q4 2013 Earnings Call

### Company Participants

- Frederico Curado, Empresa Brasileira de Aeronautica S.A.
- Jose Filippo, Empresa Brasileira de Aeronautica S.A.
- Luciano Froes, Empresa Brasileira de Aeronautica S.A.
- Paulo Silva, Empresa Brasileira de Aeronautica S.A.

### Other Participants

- Alexandre Falcao, Analyst
- Cai Von Rumohr, Analyst
- Derek Spronck, Analyst
- Eduardo Couto, Analyst
- Myles Walton, Analyst
- Noah Poponak, Analyst
- Pedro Balcao, Analyst
- Ron Epstein, Analyst
- Unidentified Participant, Analyst

### Presentation

#### Operator

Good afternoon, ladies and gentlemen. Welcome to the audio conference call that will review Embraer's Fourth Quarter 2013 results.

#### Luciano Froes {BIO 17907241 <GO>}

We're going to -- hi. Welcome, everyone. We're going to go ahead and start with the earnings call, per the agenda. And so, with that, with no further ado, let's dive right into it, please.

#### Operator

Good afternoon, ladies and gentlemen. and welcome to the audio conference call that will review Embraer's Fourth Quarter 2013 results. Thank you for standing by.

This conference call is being held during the Embraer day in Brazil, with the presence of investors and market analysts. At this time, the Company will present its Fourth Quarter

2013 results. Afterwards, we will conduct a question-and-answer session. And instructions to participants will be given at that time. (Operator Instructions)

As a reminder, this conference is being recorded and webcast at [ri.embraer.com.br](http://ri.embraer.com.br).

This conference call includes forward-looking statements, or statements about events or circumstances --

**Luciano Froes** {BIO 17907241 <GO>}

As usual, the first part of the event will -- is also being webcast. And we have colleagues joining us from abroad and, obviously, locally but not here, dialing into the call.

## Operator

-- 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 subjects 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 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 may 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; and 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 afternoon, everyone. Thank you for coming. Thank you for those attending our conference call through the Web.

So I'll just say a few words at the beginning about 2013 and 2014. 2013 was a very challenging year for the Company. We had a difficult start. But we always -- we were always confident about our ability to deliver on the results we promised -- revenue results,

profitability results, meeting our investment targets. And also our -- the progress in our programs.

And it is -- it was a great satisfaction that the whole team was able to deliver on all those guidance parameters. Of course, we had the reverse -- the reversion of a provision which we had entered a few years ago regarding the bankruptcy process of American Airlines and with a very positive outcome of that Chapter 11 process, we were able to make that -- to cancel that provision. And that gave us an extraordinary result above what we delivered, operationally speaking.

So it was, in the end, a very positive year for the Company. We were able to restore our backlog. We successfully, the 190 and the E2s, the 190, 195. And 175-E2, which will be, of course, a mainstream product for us towards the end of the decade. We also made progress in both Defense and Security and Business Jets, increasing our revenue and cash generation and margins.

So for 2014, we see another step towards growth, towards quality growth. We are trying to balance out rate of growth with profitability and cash generation. And trying to keep a very solid balance sheet, cash -- solid cash position. And in 2014, we will step up our investments, especially in the E2, as we ramp up the E2. But also in consolidation of some of our capital expenditures such as the consolidation of the factories in Evora. And also in the United States. And also the preparation for the serialization of E2 and the KC-390.

So it's another challenging year for us, probably we're going through our record-high investment level, \$650 million, which is a little bit above 10% of our 2013 revenues. But we have the solidity and the strength to do that. And everything, of course, we are investing in will translate into future results. That's why we are doing that.

So our overall strategy to diversify the Company and make it stronger and make it more global will continue. Our continuous pursuit for excellence, for productivity, for effectiveness in our processes -- all of that is present in our agenda. And we'll be able to, again, produce what we consider solid results towards the end of the year.

So we have divulged our guidance for revenues, margins. And cash flow. This is the first time we do more formal-like guidance on cash flow. That's a demand that we had from many of you gentlemen and ladies. So we, despite the higher level of investments, we expect to -- we still expect to be positive in the cash flow in the low double digits area.

So with that, I'll turn to Filippo. And at the end of the presentation, we'll be all back to Q&A. Thank you.

**Jose Filippo** {BIO 1726218 <GO>}

Okay. Thanks, Fred.

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So we go through the presentation now. And then we'll be opening the floor for questions. Starting with page three with the financial highlights for the year and the quarter, in 2013, the Company met the main guidance figures. We had net revenues of \$6.2 billion in 2013, \$2.3 billion in the Fourth Quarter. And this is the highest ever quarterly result for the Company.

As far as operating results, we had the EBIT of \$713 million. And EBIT margin of 11.4%. For EBITDA, we had a total of \$1 billion and 16.1% margin.

This was the reported numbers. Through the presentation, we'll be able to explain in numbers the non-recurring fact that Fred mentioned regarding American Airlines.

Continuing, the free cash flow generation, it was positive \$213 million, primarily driven by the strong Fourth Quarter results.

Also, an important financial highlight for the year was the liability management operations, where we were able to exchange bonds that mature in 2017-2010 by new bonds that will mature in 2023. We had about \$500 million of exchange. And that led us to a better profile in our debt, which I'll be able to detail later in the presentation.

Finalizing the financial highlights, we have the December quarter, the backlog, which is \$18.2 billion. This information was released in mid-January. And it reflects the solid growth of this backlog. And it's the highest level of the Company in the last five years.

Next page, moving to corporate highlights. We were honored to receive several recognitions by important institutions, both in Brazil and abroad. It was an important year for Embraer in that area. And also some important governance information, that we joined the World Economic Forum Partnership Against Corruption. And also we were able to be listed in the Dow Jones Sustainability Index for the fourth continuing year. And also in the ISE in Bovespa.

Next page, now entering in the business segment highlights, starting with Commercial Aviation business. We had delivery of 90 E-Jets in 2013, 32 in the last quarter in meeting our guidance.

Also, like Fred mentioned, in the mid-June at Le Bourget Air Show, we launched the E-2 program and to date we have reached 200 firm orders and an additional 200 options.

We also had a very good year in terms of orders. It was 349 new E-Jets that were sold within the current generation and the second generation. That led us to reach over 1,400 aircraft over 65 airlines in 45 countries, a well spread distribution.

Continuing with the important achievements in Commercial Aviation, starting with the delivery of the E-Jet number 1,000. This was for Republic Airlines that will operate on behalf of American Eagle. Also, we announced in the end of December an important

order for American Airlines for up to 150 E-Jets 175 model, split by 60 firm and 90 options.

Continuing, we will welcome our first version operation to Saratov Airlines . It became our first to operate in Russia. They have 2 195s. It's important, because we consider it a potential very good market going forward.

Finalizing the highlights for Commercial Aviation, the recent announcement of Air Costa's order was this year after we had the last announcement for 50 firm orders, plus 50 options of the E2 model.

Continuing highlights, now in the Executive Jet business, we delivered 119 executive jets in 2013, reaching our guidance with 90 light jets and 29 large, 53 of them delivered in the Fourth Quarter.

Some important achievements of the Phenom family, that the -- they surpassed both 100 and 300, 470 aircraft deliveries to 29 countries. And also we were recognized by the Phenom 300. It was the most-delivered aircraft in the executive jet business in the industry in 2013.

Regarding the new Legacy 450 and 500 program, the Legacy 500 reached 1,100 hours of flight test. It's scheduled to enter into service in the first half of the year. And the Legacy 450 had its first flight in the end of December of last year. It's expected to be entering into service in 2015.

Continuing the Executive Jet highlights, we had the first delivery of the China-assembled Legacy 650. It's early January this year.

And also, we launched a new Lineage 1000E which enhanced range. And also interior features.

Regarding recognition of Embraer for customer support, we continue to be recognized by industry (experts) as best of class. We had for the second consecutive year recognition by AIN. And we also expanded and continue to expand our service center network, adding 60 facilities in 2013, which now accounts for 76 service centers globally.

Moving on to Defense and Security segment, revenues grew of 15% in 2013, reaching \$1.2 billion. It's a record for this segment of Embraer.

Some activities of (inaudible), the Atech growing activities highlighting the signing of another aircraft -- air traffic control contract with the Brazilian Air Force.

Also, Visiona, our joint venture with Telebras that develops the Brazilian satellite program, we continued to select important suppliers for this project.

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And related to BRADAR, in 2013, we continued to increase its activities in BRADAR business with serving Brazilian Air Forces.

Another focus of Defense and Security, we -- our Jacksonville operation is moving along, as planned. The first delivery of a Super Tucano is scheduled for mid-2014.

We also concluded the delivery of the final 3 Super Tucanos for the national air force of Angola.

And in the modernization program, we continue to advance with the delivery of the second modernized A-1 fighter jet for the Brazilian air force. And performed the first flight of the two-seat prototype.

Regarding the KC-390 program, the assembly process is underway. First flight scheduled to the end of 2014.

Now, moving on, financial figures and results, starting with the deliveries, just consolidated information. We had the delivery of 90 aircraft for Commercial Aviation. And 119 commercial-- for Executive Jets, within our range for the year.

The backlog, as we released early -- in mid-January, the total amount this year at the end of the year, 2013, grew 46% compared to 2012 to \$18.2 billion, reaching, like we mentioned, its highest level in five years. Most of it comes from Commercial Aviation, reflecting the strong orders for both the current and the second generation of E-Jets. And here we see the breakdown of this backlog, 67% for Commercial Aviation, 20% Defense and Security. And also 13% for Executive Jets.

In relation to net revenues, the total of \$6.2 billion in 2013, slightly above last year. And meeting our guidance. This figure also represents the highest since 2008. And meeting our guidance range of between \$5.9 billion to \$6.4 billion.

In terms of splitting the revenues by segment and region, we see the continued diversification by segment, with the relative reduction in Commercial Aviation and growth of Executive and Defense in the last slide, coming from 61% in 2012 to 53% in 2013. That's what we already indicated when we gave our guidance range for 2013. This is more firm. And 27% Executive Aviation, 19% for Defense.

In relation to regions, in the right side we see a well-balanced distribution with our main markets being North America, Europe. And Brazil.

Page 15 -- the net revenues, on a quarterly basis in Brazilian reals and dollars, highlighted for the strong Fourth Quarter where we had, in terms of dollars, \$2.3 billion. In terms of revenues, the amount, total of \$6.2 billion in the year. And in reals, almost BRL5.3 billion in the last quarter, BRL13.6 billion in the full year.

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Page 16 -- the SG&A expenses and its evolution in the last years, reflecting our cost control focus, bringing the SG&A to its lowest level in three years. Important that this program and that this process is something very important for the Company. Been working very hard on this. And I will be able to see the results. We had the total amount of \$664 million in 2013, which accounts for 11% of sales, a reduction compared to the previous years.

Next page, broken by quarter. We show the consistent control (inaudible). So we see by quarter that we have these figures stable. Total, like we mentioned \$664 million for the year in dollars and BRL1.4 billion in 2013.

Next page, talking about operating results, at this point it's good to mention that we had this positive impact of the American provision reverse, like Fred mentioned, as the Company concluded its restructuring program. We had a positive impact of \$147 million. But the reported numbers of \$713 million with a margin of 11.4% would be \$566 million with a margin of 9.1. Even excluding this effect, we were in line within our range that we indicated, not only in terms of amount of dollars. But also in terms of margin.

On page 19, operating results by quarter, we see the strong performance and the operational leverage in the last quarter, 20.1% margin in dollars. And 13.7% without the American non-recurring effect. And also, in reals, the total amount of BRL1 billion. And BRL723 million, excluding the American effect.

On page 20, in relation to EBITDA, we also saw the strong result in the Fourth Quarter with \$1 billion of EBITDA and 16.1% margin. As in the same way, if we exclude the American non-recurring impact, it would be \$857 million in terms of EBITDA, with 13.8% margin, in our range of guidance.

The information of EBITDA by quarter, following the same pattern that we saw in the EBIT, we had a strong Fourth Quarter. Most of the results were coming from that period. This -- over \$500 million in EBITDA, with almost \$400 million, excluding the American effect in dollar terms.

Net income on page 22, results in 2013, \$342 million, with a net margin of 5.5%. And net income -- sorry, net income divided by quarter, we have this strong Fourth Quarter, with margins that would definitely contribute to the blended one, over 10% margin in the last quarter.

The earnings per ADR reached \$1.88 in 2013. That reflects a payout of 36%, which is consistent with our strategy, which includes the quarterly payments that we've been doing.

Next page, page 25, as far as inventories, we finished 2013 with \$2.3 billion in inventory, similar levels to prior years, also reporting an important focus of the management to avoid increasing. And keeping inventories under control.

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On page 26, in terms of free cash flow, we ended the year with a positive figure of \$213 million. This was, of course, as a consequence of the strong performance in the Fourth Quarter, primarily due to the aircraft deliveries in that period.

We had -- if we break here, we have the total cash generation through operating activities of \$967 million, partially compensated by the investments in PPE of \$438 million and intangible assets of \$317 million, with a net of \$213 million in 2013.

Page 27, total investments in 2013 of \$534 million, slightly below our outlook. We had the split by \$193 million in CapEx, \$265 million in development. And \$75 million in research. This -- the total investments was a little bit below the outlook that we gave of \$580 million.

In terms of our capital structure and finalizing the presentation before we do the guidance, we had an improvement of the debt profile this year, as you can see in the left side, under the debt maturity. We were able to extend the terms from 5.8 years average terms at the end of 2012 to 6.2 in the end of 2013, mostly because of the exchange operation that we mentioned of the bonds. But also important that we reduced our short-term portion of the debt from 16% last year in 2012, to 4% in 2013.

Our net cash position was \$429 million, because of the cash generation that we mentioned in the page before.

With that, we enter into the outlook for 2014 with our guidance range, figures that we plan for 2014. As Fred mentioned in the beginning of this call, we are slightly increasing our net revenue range to \$6.5 billion if you compare to what we gave last year. EBIT and EBITDA margins remain stable in the range of 9% to 9.5% for EBIT and 13% to 14% for EBITDA. And the range of \$540 million to \$620 million for EBIT and \$780 million to \$910 million for EBITDA, as far as those total ranges.

In terms of cash flow, we're introducing information in our guidance for free cash flow. So according to our outlook, we indicate that the free cash flow should be positive in the range of -- or in the line of low double digits.

On page three of the guidance, revenues and deliveries arranged by business segment, in the Commercial Aviation our forecast is a slight increase of aircraft deliveries, in the range of 92 to 97, which reflects into the range of revenues to \$3.2 billion to \$3.4 billion for the year.

In Executive Jets, the delivery should be stable, in the range of 80 to 90 light jets and 25 to 30 large jets. And the revenues of \$1.5 billion to \$1.7 billion in 2014.

In Defense and Security segment, we are increasing the range from last year to \$1.2 billion to \$1.3 billion when we compare to the released figures.

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To finalize and to sum up the amount of Embraer as a whole, we are indicating the other revenues of \$100 million. So we're close to the range that we indicate for Embraer as a whole.

If we take the mid-point of the range of revenues by each business, we'll have 53% of the revenues coming from Commercial Aviation, 26% for Executive Aviation. And 20% to Defense and Security. And the others will be 1%.

Next page, closing our guidance for 2014, in terms of investments, we are indicating the total amount of \$650 million for the year. It's an increase compared to 2013, basically due to the E2 development program and the final stages of the development of the Legacy 500 and 450.

So we have the indication of research for \$80 million, development \$320 million. And CapEx \$250 million. And a total of \$650 million for 2014.

Okay, with that, we finish the presentation. And we'll be open for questions. Thank you.

## Questions And Answers

### Operator

Now we will open for questions, starting with participants in the audience and followed by participants in the conference call.

#### Q - Eduardo Couto {BIO 18009973 <GO>}

Hello. Hi, guys. Congratulations on the results. It's Eduardo from Morgan Stanley. I have two questions, one regarding the guidance.

Can you tell us whether the BRL was the currency that you're assuming for this 2014 guidance?

And the second question, more on the different divisions. There are some rules recently by the Brazilian government to steady the budget for expenses. And there was, I think, a big cut on the defense sector. I just want to know if this is going to affect Embraer, if it's going to affect the current projects like the SISFRON, like the KC-390? So what this budget cut could mean for ERJ?

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

Thank you. The FX assumption in our guidance is actually very close to the current level, 2.35. And at this stage, we have not received any indication of any cuts in the budget of our programs. So we understand the KC-390 and the SISFRON. And the other, small, programs in which we are engaged are key to the strategy of the Brazilian Defense Ministry.

So I mean we would not at present expect any budgetary cuts. But, of course, that may happen. Having said that, we are still comfortable with our guidance. So on the \$1.2 billion, \$1.3 billion for the year.

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

Fred, I've got one here. Myles Walton, Deutsche Bank.

So when you have the 9.5% EBIT margin, can you give us some color as to the gross margin versus the SG&A portion? And also, as you look to 2015, what your opinion is or outlook is for stimulus that you have in '14 that may or may not be there in '15?

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

Thank you, Myles. Welcome to Brazil. We, of course, now the major headwinds in 2013 -- in '14, I'm sorry, is probably 1.5% to 2% reduction in gross margins on the commercial jets, which is still our main business. So we intend to compensate that with better margins in Executive Aviation, hopefully also in Defense. Of course, the real in the specific case of Defense, as we grow the participation of revenues in reals, that effect may turn out to be a little bit negative, the devaluation of the currency, which -- but it's good for the Company, overall.

So probably we're going to miss a little bit in gross margin and make that difference in SG&A. But the gross margin should not be way off of what we saw -- I mean, compounded margin for the Company not much lower than what we saw in 2013. So if there is any slight decrease there, we are continuously striving with our SG&A to keep reducing it to levels which are competitive.

So as far as 2015, we are a year away from that outlook. But we -- I mean, we (inaudible) investment-wise we're probably going to see similar levels of investments. We will have, most likely, better -- a better performance on Executive Jets due to the ramp-up of the Legacy 500, which will be already in production for six months at the beginning of the year. So 2015 we expect higher deliveries of Legacy 500s, of course. And also the introduction of the 450. So we should have a better picture for business jets.

And we don't see at this stage, certainly not any worse in the Commercial Jets. So we see a stable and with, maybe, some upside risk on Commercial Jets, because there are several options which are to be confirmed, especially, for the US, which, if they're confirmed, may have some -- some higher -- some more, not higher, sorry, some more deliveries in 2015.

So '15 at this stage looks good.

I don't know, in the back --

**Q - Pedro Balcao** {BIO 3321352 <GO>}

Pedro Balcao with Santander.

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

Sorry.

**Q - Pedro Balcao** {BIO 3321352 <GO>}

I think the last time --

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

Sorry, (inaudible).

**Q - Pedro Balcao** {BIO 3321352 <GO>}

Oh, I'm sorry. Pedro Balcao from Santander. I think the last time we spoke, you kind of stated an indication that we could have (inaudible) in Commercial Aviation in 2014, between 200 to 300 (inaudible). And that you have now a more positive view on that possible decline of market in 2014. Is that the case, or have I misunderstood?

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

I don't -- as I said, I don't remember. Yes, go ahead.

**A - Jose Filippo** {BIO 1726218 <GO>}

As far as the first question --

**A - Luciano Froes** {BIO 17907241 <GO>}

Yes. We reiterated generally at the previous Investor Day in New York that it would have been roughly around 200 to 300. So, after some final, let's say, definitions, I'd be -- the headwind is still there. But it tends to be, probably, in the range of 150 to 200 basis points.

**Q - Pedro Balcao** {BIO 3321352 <GO>}

Could you give some color on what is not so bad that we expected before?

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

It wasn't so bad? Maybe Paulo can help us here. I don't have the precise numbers in my head. But, I mean, we have a decent pricing on the aircraft. So I think there was, maybe, an over-pessimistic expectation about what will be a 175 pricing. For those campaigns in the United States was held relatively firm. And, of course, on the cost side, we keep working on that.

Paulo will talk about that in a little bit more detail during his presentation. But the fact that the 175 with the fuel-burn improvements is actually burning 6.5% -- 6.4%, to be precise, less fuel than the previous 175. That's a major, major cost element -- cost reduction element for the airlines.

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So I think that's going to help us to keep a stronger price than what we forecasted initially for this project. But Paulo, if you can add some more light, please?

**A - Paulo Silva** {BIO 17023173 <GO>}

Okay, Fred. Thank you. Yes. In addition to this, we have also the (inaudible) for the 190 (inaudible) helps a lot in the (inaudible) environment. And also important the management of the depreciation of the real, which, of course (inaudible).

A third element is the development of the services, selling of parts business. This provides (inaudible) margin of profitability.

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

Thank you, Paulo.

**A - Luciano Froes** {BIO 17907241 <GO>}

Just complementing there, exactly on the exchange rate, we saw from the time of the end of the Third Quarter, when we were discussing those figures, the real was at around 2.20, 2.23. And so, we just spoke, of course, of our assumptions here, as well.

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

Noah has been raising his hand in the back for a while.

**Q - Noah Poponak** {BIO 16071528 <GO>}

Okay. Thanks. Good morning, everyone.

I wondered if you could just provide a little bit more detail on where you are with the development of the Legacies. There's no change in the timeline here. But as you get in the very late stages on those aircraft, can you just -- are you feeling a little better three, six months ago. And what's left to be done? And how likely are they to now stick to the current timelines?

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

Thank you, Noah. Thank you for coming all the way down to Brazil.

We feel really good about what we've seen in the Legacy. As Filippo just mentioned, we just surpassed 1,100 hours of flight tests. Prototypes are flying well, high dispatch ability. We do have, of course, typical challenges of this final sprint of certification, which we're still shooting for mid-year.

Probably we'll deliver something between 3 and 6 airplanes in the second semester. It's a slow ramp-up, deliberately slow. We're investing significantly in maturity of all systems. As you may recall, we did have some issues in the introduction of the Phenoms in the

marketplace, which of course, is more costly to improve the fleet in service, than it is investing in maturity up front.

So several, dozens of rigs for several systems are prototypes, just for F&R, function and reliability. We'll start flying -- I think it has already started flying, right? So to the end of the month, it's like two more. So we'll have these airplanes flying very, very intensively as function and reliability.

So the idea is to have a smooth ramp-up in the second semester. And really make it steeper in 2015.

The 450, of course, will inherit all the benefits of what we do in the 500. The airplanes have a very high degree of commonality. They are fundamentally the same airplane, shorter fuselage. Other systems are the same. So it will be differently from what we had in the Phenom 100 and 300, which are two different aircraft.

So the 450 seems to be even smoother than the 500, with all the lessons learned in 12 months of operation of the 500. So at this stage. And Marco, for sure, will go into more details during his presentation.

#### **Q - Noah Poponak** {BIO 16071528 <GO>}

Okay. Thanks. And then, Fred, I just wanted to ask you for your latest thoughts around the overall health of the overall small and mid-cabin business jet market, not just your business. There's been a little bit of sort of hope in some of the recent data, whether it's utilization or pricing in the secondary market. But there's also extremely easy comparisons with some of that data.

You're calling for sort of a flat production level, '14 versus '13. What's just your latest overall thoughts on the health of the market and when we could finally see a more substantial recovery?

#### **A - Frederico Curado** {BIO 2004589 <GO>}

Noah, I have a little bit of a hard time to hear you. But if I don't answer what you asked, please interrupt me or correct me.

We -- the lower end of the market is still the weakest, in our point of view. We are favoring more, let's say, higher production rates on the Phenom 300s than the 100s. We have a specific effort to reduce -- I mean, sorry, to increase the pricing on the Phenom 100s, even if that costs us a slight reduction in production.

On the other hand, the 300 is really performing well, selling well. And has a strong pricing. So we have this perfect situation in the 300 where we have the market leadership and the highest price in the segment.

So I think we have to do a better job in the 100 to improve its pricing power. It's a lot of airplane to what we have been selling it for. And we have, overall, good feelings about the industry. So it looks like those faint signals are getting more and more visible. So let's see how 2014 unfolds.

I'm not sure I answered your question.

**Q - Noah Poponak** {BIO 16071528 <GO>}

No. That's helpful. I appreciate it. Thank you.

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

Thank you.

**Q - Unidentified Participant**

Hi. Good afternoon. Good afternoon, everyone. You've been investing quite heavily in services on the Commercial side, particularly the spare parts pool, which I think Paulo just mentioned as a driver. Could you characterize where you are in terms of the earnings recognition on that investment? Is this very strong development this quarter, was that a significant driver or only a very small one? And when look over 2014-2015, could that be a source of margin upside then (inaudible)?

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

I need Luciano's help here.

**A - Luciano Froes** {BIO 17907241 <GO>}

Yes, Joe, to give you a bit of the sense of the revenues, we have seen continued growth in the services side. For 2013, total services revenues represented around \$840 million. That's, of course, between all the business units. And the investments that you're referring to, they'll occur as, of course, we're able to expand our base of customers that enter into our pool program of spare parts. So it's an ongoing strategy on that front, which is already showing some growth, as I mentioned in the figures of the revenue contribution.

**Q - Unidentified Participant**

Is that -- when we looked at this year and next year, 2015, there's so much cash going into it. Maybe there's -- are we in the second inning, baseball terms, of starting to get a pickup? I'm really focused more on the margins than I am on the sales. I know this -- of course, (inaudible) sales and margins. But this seems to be a very high margin (inaudible) business.

**A - Luciano Froes** {BIO 17907241 <GO>}

Yes. It does tend to be higher in the range of the operating margin. So that continues to be the case. And we do expect to see some continued growth in that participation, yes.

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## Q - Unidentified Participant

Then, just on the Executive guidance, I understand the market's not coming back as anyone -- everyone would like it to. But you do have the Legacy 500 deliveries, 3 to 6, I think you said, coming in this year. You have your Chinese venture contributing, I think, more this year. So is -- what level of conservatism do you think you've baked into your Executive guidance?

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

Joe, that's a very fair question. We are not having the success we thought we would in China by having the factory there. So delivering this aircraft, we'll probably deliver another one or maybe two this year, which, as you may recall, our plans would be for many more than that. So that's one side.

I guess, when you look at the large cabin, we are still trying to play with what's the right balance of pushing wide tails down the line and having to make concessions on pricing or having more balanced production, more control. And try to keep prices up. There are situations -- there's at least one competitor which has a very, very aggressive pricing strategy to -- cash-driven strategy, which really it's still creating some disturbance in the market.

So we -- overall, we decided to favor pricing and strengthening of our capital -- working capital other than just push numbers out. So if the market rebounds, we have a relatively -- I'll say a very competitive speed in reacting to any potential upside. So we can probably turn out an increase in production rate faster than, I would guess, most of the OEMs.

So it's not a call that we did hold growth a little bit and try to get our act together in a better way as far as cash, as far as margins.

Around here? I'm sorry.

## A - Luciano Froes {BIO 17907241 <GO>}

Right here in the front.

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

Oh, yes.

## Q - Unidentified Participant

Fred, my question is also about the margins. I don't want to get into guidance for 2015 today. But I'm just trying to understand, as you look for '13 to '15, does the currency and, I guess, maybe the stimulus package the only two major wild cards in terms of -- and I guess, also, the (inaudible) market, maybe if that comes back, that would be upside. But I'm just trying to think about downside risk to margins in 2015, is it just the currency and the stimulus package that would be the major important factors there?

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

I'm not sure I fully understood your question. That's for '15?

**Q - Unidentified Participant**

Yes, for '15. So if I'm assuming sort of flat margins from '14 to '15, would the risk really come from those two factors, or is there something else?

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

Yes. Sorry, now I get it. Currency, of course, is something hard to forecast. Our view is that -- or our plans are not based on any major spike, up or down. So 2.35 is our -- the assumption for this year. I think the pressures are more for the real to be devaluated rather than valuated. But Brazil is in a very strong economic position. So I don't think Brazil would just let its currency melt down. And I think the current level -- we don't expect a major devaluation in the real. So if there is any change there, it would probably be on the slight side favor than unfavorable.

As far as the stimulus package, as you may know, part of it was already removed in 2013. It's not renewed, which is that slight compensation for the taxes embedded in our supply chain in Brazil, which affect all exporters in Brazil. Most unfortunately, that was removed. But the problem is still present in our lives.

On the payroll, we will not know until the end of the year. But all the indications that this change, which did affect hundreds of thousands of companies and most of the sectors of the Brazilian economy. So the expectation is strongly that this will be maintained, will be something for good. But we will not know until we know it.

**Q - Unidentified Participant**

And I guess just maybe the quarterly progress in the margins in 2013 was a lot more Q4-weighted. I guess -- I know usually Q4 is a big quarter. But it was a lot more so, I would say, in 2013. Should we expect something similar in '14, or is it going to be a little bit more stable next year.

**A - Luciano Froes** {BIO 17907241 <GO>}

So (inaudible), of course, broadly speaking, yes, we would imagine starting off with a relatively light First Quarter. And then building up in the Second Quarter and Third Quarter, relatively flattish to maybe slightly down. Of course, we'll have to see how things end compared to Second Quarter. Then a busier Fourth Quarter, generally speaking. So that should be the layout of 2014.

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

Just complement -- this has to do with Joe's question about the business jets. Of course, the more backlog you have in the short term, the easier it is to plan production. So when you plan too much of a (inaudible) in the end of the year, they irreversibly fall into the last quarter. So we are definitely don't like that behavior of having a very, very strong Fourth



Quarter, which is a stressful situation for management. But probably we'll make some progress this year. And hopefully we'll have a more stable in the next few years.

## Q - Unidentified Participant

Thank you.

## Q - Alexandre Falcao {BIO 5515455 <GO>}

Hi. Alexandre Falcao from HSBC. I just wanted to get a glimpse on, or a little more color, on where we could see surprises in 2014 in terms of the three segments and the upside, of course. Is this business jets that could surprise to the upside, or commercial with a new round on American aviation or even Asian aviation? Thank you.

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

I apologize, guys. But the sound is really tough here to understand. So well, I think if I get the question right about upsides, I would not consider any upside risk beyond our guidance at this stage. As I said a few minutes ago, if there is a market rebound stronger than what we expect, we can react pretty quickly. We have the ability to -- not only through internal to mobilize our internal resources. But also our supply chain to make a fairly quick reaction to a potential upside in the market.

I'm not sure that was your question.

## Q - Alexandre Falcao {BIO 5515455 <GO>}

Yes. Thank you. And just one follow up in terms of the competitive scenario. Do you see Bombardier, I believe, should deliver or are delivering their new aircraft. And Mitsubishi and Comac also stepping up to the plate here. Do you think that the competitive scenario is going to get tougher going forward, or the same scenario as you saw in 2013? Thank you.

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

Yes, I don't think there will be any material difference between what we saw in '13 and '14. Mid to longer term, it always gets worse.

We cannot rule Bombardier out of the game. They are there. They're a strong company. We continue not to believe in the business case of the C-series. But they have the CRJ line. They took about a quarter of the sales for the United States. We got three-quarters, they got one-quarter.

So that shows us, instead of celebrating that we go three-quarters, they are still there. And we have -- we lost a quarter of the market to them.

We have to watch how the Superjet, the Russian Superjet performs outside the Russian environment. We have to follow their operation in Mexico to see how much, let's say,

they're really prepared to face a tough airline environment of high-frequency, high dispatch reliability.

So it's -- keeping in mind, of course, that airplane is of the current generation. So we feel good about the 190's E1 ability to compete against the Superjet. And we feel really good about the E2, 190-E2 to compete against the Superjet. Same with the Chinese.

So we continue to see difficulty. Obviously, the focus in China is much more now to the C919 rather than the ARJ21. So we respectfully believe that they will be -- they will have some difficulty to sell their airplane abroad in large quantities, the ARJ21. And again, that is also an airplane of the current technology, which the 190-E1 can give a very good fight. The E2 can really be a leap ahead.

The Mitsubishi has the new engines, Pratt & Whitney. On paper, the airplane is more in line with our 175-plus, our 175-enhanced. And the 175-E2. With the new delay that they announced last year, they will not come into the market until 2017. Is that correct, Paulo? So 2017, the big advantage that they would have, which is access to markets, early access to markets, is pretty much gone.

So I think we still have a sound case with both the E1 and the -- certainly with the E2 towards the end of the decade.

**Q - Alexandre Falcao** {BIO 5515455 <GO>}

Thank you.

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

Yes. We have to -- it's about time to stop. So, I think should we give -- but also we have here. But should we give, also, the chance for the people in line to --?

**A - Luciano Froes** {BIO 17907241 <GO>}

Yes, please.

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

So let's take this question here, please. And the one there.

**Q - Unidentified Participant**

I just want to ask one on Defense revenue in the quarter. It came in a little below guidance. Was that solely due to the real devaluation, or is there something else going on?

Then Part B is sort of the 2014 Defense guidance. Does that reflect an underlying double-digit growth because of the real headwind? Is that (inaudible)?

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

Yes, I think it has a lot to do with the real. And as I said, there is no -- as of today, we have no real change to the scenario of organic growth in the programs. But the real -- there's a difference of 35 cents on the dollar from last year to this year. So it's driven by that.

**Q - Unidentified Participant**

Thank you.

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

And we have one there. Because we can always close the line. And then continue here, of course.

**A - Luciano Froes** {BIO 17907241 <GO>}

Yes. So we'll go ahead and see if there are any questions from the people that are attending from the phone.

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

Can you hold your question? Let's just check whether we have somebody -- then we can shut down, shut off. And then we will come back to you.

**Operator**

And now we will open for participants on the conference call. And now we will open for participants on the conference call. (Operator Instructions) Our first question comes from the line of Ron Epstein with Bank of America. Your line is open.

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

Hi. Good afternoon, Fred. Hope you're doing well.

A quick question. We haven't talked much about -- how should we think about the bridge between the demand for the current generation E-Jets and the E2 jets, right? Because I guess, what, they go into service in 2018. And here we are, I guess it's 2014.

So how should we think about the bridge between the two series of jets and how you're seeing demand for that bridge?

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

We -- hello? Hello?

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

Hello.

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

We feel good about it. That's Ron, right? We feel good about it. In '14, the numbers are out there. '15, we are cautiously optimistic about '15. '16 and '17 we -- I think we have two situations. One, there are several -- a large number of options, which in our point of view have a likelihood to be confirmed, especially, as Paulo called, a second wave of renewal of the RJ fleet in the United States. We believe the E1, the 175-E1, will be very well positioned to take that.

But also, the activity that Paulo will go into more details later, that we see today, we see, still, a demand for the E1 types. And sometimes combined orders for E1s and E2s. So at this stage we feel relatively comfortable about our ability to make that bridge without any major hurdle from now to the introduction of the 190-E2.

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

Okay. Great. And maybe just one more quick question. There's been a fair amount of, I guess, press, trade press, that there's a push to do more regional flying within Brazil.

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

No more questions from the phone line?

**A - Luciano Froes** {BIO 17907241 <GO>}

No more questions from the phone line?

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

Hello?

**Operator**

Ron, please proceed with your question.

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

Yes. So the -- there's been some press about more regional flying in Brazil and with airlines like, I guess, Avianca Brazil and TAM pushing more into regional flying, I guess, by a mandate from the Brazilian government.

Do you think that's a real opportunity. And if it is, I mean, how big could it be?

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

Back to the phone question about regional aviation in Brazil. Let's keep in mind that between Azul and Trip, we already have 83 E-Jets in there, flying in Brazil, compared to zero a few years ago. So there has been a strong development already. So if this package goes through Congress. And I have all the reasons to believe it will go through Congress,

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that's a desire of the Brazilian government to really foster the social development in the hinterlands of Brazil.

Again, I think we are well poised to benefit from that. We do -- in the events we do in Europe, we do in China. And I have to believe that we'll do, at a minimum, as well as we do abroad, we'll do in Brazil. So hard to put numbers into that. But let me just give you one figure. About 25 years ago, Brazil had 252 airports with commercial service. Today we're down to 150.

So the potential is there. There's 100 airports which, with a little investment, they can receive again commercial traffic. And the (inaudible) of those passengers, they will probably go towards a smaller aircraft, rather than a big, narrow-body aircraft.

So that's how we see it. It's an upside.

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

Okay. Great. Thank you. So much.

**A - Luciano Froes** {BIO 17907241 <GO>}

We have one more question from the line. And -- hello? Hello? Yes. Thank you. We have one more question from the line. And then we'll come back for the final two questions here in the local audience and conclude, please. Thank you.

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

There will be more Q&A at the end, again. So we'll be here.

**Operator**

Okay. And our next question comes from the line of Cai Von Rumohr with Cowen & Company. Your line is open.

**Q - Cai Von Rumohr** {BIO 1504358 <GO>}

Yes. Thank you very much. And good results. A quick question on development. You said \$320 million in 2014. Could you give us some color on the expected profile in the next couple of years, given you've said the development of the E2 would total \$1.7 billion? Thank you.

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

Thank you, Cai. We -- in 2015, we foresee, at this stage, pretty much stable total investment. We probably will reduce -- CapEx will probably be equal or less than the 2014 figures. So we may have some increase in R&D, especially with E2. But as the 500 will be certified and the 450 will be in the final sprint of certification, there will probably be an offset there.

So as a model, if we model out pretty much in line with '14, I don't think you'll go wrong.

**Q - Cai Von Rumohr** {BIO 1504358 <GO>}

Then, the last question. You talked about CapEx of \$250 million. Does that include the spending down under contract for government? And what does that assume about spare parts inventories?

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

We -- in those numbers, there are no figures for the contracted CapEx, if you will, the CapEx which are embedded in development contracts, such as the KC-390. So that's CapEx fundamentally for Commercial and Executive Jets. I'm not sure that answers your question.

**Q - Cai Von Rumohr** {BIO 1504358 <GO>}

That does. Thank you.

**Q - Unidentified Participant**

Another question on the order environment. Another question on the order environment, more specifically in 2014. Coming off a strong year in 2013, how should we be thinking about book-to-bill in Commercial Aviation?

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

Sorry. I re-apologize. The sound is terrible here. So would you mind to repeat the question?

**Q - Unidentified Participant**

Sure. Just a question on the order environment in 2014 after a strong year in 2014. How should we think about the book-to-bill?

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

I hope Paulo and Marco Tulio and Jackson will tell you that we're shooting for at least a 1-to-1 book-to-bill ratio. So there's a big momentum in Commercial Aviation. So we really feel good about it. And there will be a very strong push from Marco to increase sales so we can enter 2015 with a higher backlog in Executive Aviation, as well. So minimum 1-to-1 book-to-bill ratio, that's what we consider.

**Q - Derek Spronck** {BIO 17904184 <GO>}

This is Derek Spronck at RBC Capital Markets. Most of my questions have been answered. But a quick one. How much additional capacity, production capacity, do you have on the E-175 or the Phenom 300 lines?

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

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We -- not exactly production rate. But the limitation today is not our production infrastructure, it's the market. It's sales. So historically we delivered -- I think our record year was, I think, like 165 E-Jets. So that can tell, easily, how much capacity we have. Of course, you have to add people if we add production rate. But the infrastructure, tooling. And everything else, is in place.

As far as the Phenoms, between Melbourne and Brazil, we also have, let's say, sufficient room to accommodate an increase in market demand.

**Q - Derek Spronck** {BIO 17904184 <GO>}

Would you see a production ramp would be roughly, say, 8 to 12 months?

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

The ramp-up? That's probably a fair figure. Probably more on the eight months.

**Q - Derek Spronck** {BIO 17904184 <GO>}

Thanks.

## 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>}

Well just to thank everyone for attending our conference. Have a nice Carnival. Carnival is next here in Brazil. And a wonderful 2014. Thank you.

## 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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