

Q3 2012 Earnings Call

Company Participants

- Frederico Curado, Empresa Brasileira de Aeronautica SA
- Jose Filippo, Empresa Brasileira de Aeronautica SA
- Luciano Froes, Empresa Brasileira de Aeronautica SA

Other Participants

- Amit Mehrotra, Analyst
- Carter Leake, Analyst
- Milan Posarac, Analyst
- Nicolai Sebrell, Analyst
- Noah Poponak, Analyst
- Pedro Balcao, Analyst
- Peter Skibitski, Analyst
- Ron Epstein, Analyst
- Stephen Trent, Analyst
- Unidentified Participant, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. Welcome to the audio conference call that will review Embraer's Third Quarter 2012 results. (Operator Instructions)

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, estimate, 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. Jose Filippo, Chief Financial Officer and IRO; Ms. Elaine Funo, Director, Corporate Controller; and Mr. Luciano Froes, Director of Investor Relations.

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

Frederico Curado {BIO 2004589 <GO>}

Thank you, very much. Good morning, everyone. Thank you for joining us for this Third Quarter conference.

Before I switch over to Filippo that can walk you through the presentation, just a few comments which I think are relevant. Our results, obviously, they were impacted by provisions that we have to constitute to -- in support of Chautauqua financial restructuring. And as we have said in our press release and in spite of these impacts, these extraordinary provisions, we still believe we'll be able to maintain our guidance for operating results for this fiscal year.

Particularly, a couple of points which made us very happy and kind of reinforced us that we're the best, the undertaking of the Company's (inaudible) as far as improving its governance, improving its efficiency. For the third consecutive year, we were included or have been included on the Dow Jones Sustainability Index, which of course is -- the Company, which we think it's very important, very high standard of corporate governance in the United States.

And we are also part of the similar sustainability index in the Sao Paulo Stock Exchange. And in that case, particularly, we have been faced with -- since the actual creation of the index, the ISD. So, that was good news.

Another important development for us was the opening of our two new centers of excellence in Portugal. They will be fundamental pillars for -- of our fabrication of large structures going forward, for both metallic and in composites. And we're on time on budgets. So, that also was an important result for us.

And one last particular comment before I turn to Filippo which makes I think all of us. And certainly myself, very happy and proud that, amongst several external recognitions and market recognitions about our people management, we received for the first time ever the award for the best company in Brazil in all categories for people management. And we -- as we believe that people are really the center of our strength and our future, this is a very important feedback and, of course, just raises the bar for us to keep striving to have a company of excellence.

So, having said all that, I will ask Filippo to walk you through the highlights of the businesses and, obviously, the financial results of the quarter. And I'll be back at the end with the rest of the team for your questions. Thank you.

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Jose Filippo {BIO 1726218 <GO>}

Okay. Thank you, Fred. We'd like to go through the highlights of the -- each businesses. So, we're talking about the page four, the highlights in the Commercial Aviation business.

We had the 27 deliveries in the Third Quarter coming from 35 in the Second Quarter, already 83 year to date. So, we expect a stable forecast for the Fourth Quarter. And as Fred mentioned before, we are confident that we're going to be able to reach the guidance given early this year.

Also, we started the operation with three new operators of E-Jets, expanding our E-Jet operation off a very good base. And also, we signed the deal with Conviasa for potential 20 jets. And the first one, the first delivery happened now in the Fourth Quarter 2012.

An important milestone in the E-Jet program was the delivery of the E-Jet number 900 that occurred in October to Kenya Airways.

And concluding the highlights for Commercial Aviation, we informed in mid-September that we entered in a letter of intention for supporting Chautauqua's restructuring program, already impacted -- was recognized in our financials of this quarter. And we hope that we can have a full disclosure after having signature of the documents. We expect it to happen before the end of the year.

Next page in terms of the Executive Aviation, page five, we had the -- as a highlight, the delivery of 13 jets in the Third Quarter. We're now 46 year to date. And as typically we have the seasonality of this business, we expect to grow in terms of delivery the Fourth Quarter of this year. Important in terms of the deliveries of the Third Quarter is that we have two large jets and one Legacy 650 and one Lineage in the quarter.

Also important highlight is the recognition of the Embraer Executive Jets, two important two places, the Aviation International News and Professional Pilot magazines. We were upgraded in terms of the position for customer support, which was very important for the business and happened this quarter.

We also started the Executive Jet Service in Sorocaba, Brazil, for maintenance this quarter.

And the last comment is the initiation of the fabrication of the Legacy 450, which is an important milestone in the Legacy family.

Next page, page six, in terms of the Defense and Security, this segment still experienced high growth. In terms of revenues, we had this quarter 37% growth in terms of sales compared to last year. It's clearly strong and consistent growth. We expect to see performance in this business, which we believe is important for the portfolio of the Company.

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We had important information[ph] on the KC-390 program that we had preliminary design review completed. And that confirms that we are completely on schedule for this project.

Also, the announcement of the -- from the Brazilian Army of the chosen Brazilian -- the Savis and Orbisat consortium led by Embraer for the Sisfron next phase, this (inaudible) us to have potential revenues of \$400 million within the next three years. And we expect to have the documents signed by the end of the year, which is the long period. At this moment, we are discussing and working on the documentation for signing by the end of the year.

Continuing the highlights, the deliveries of Super Tucanos for Indonesian Air Force and Mauritania as well as the first AEW for India.

And finalizing the highlights of Defense, we have the announcement of contracting of Embraer to supply logistics as part -- in service to Brazilian Air Force aircraft, the ERJ-145 fleet.

And with that, we conclude the highlights. And we start in page seven the summation on financial information following the revenues by segment. On the top left, we have the \$1.4 billion of revenue in the Third Quarter. That -- we have accumulated \$4.3 billion in the year. And in line with our guidance, we expect to deliver what we indicated in the end of the year.

Commercial Aviation, going to the right, \$2.9 billion accumulated in the year, we expect to see stable performance for the Fourth Quarter, again meeting the guidance.

In the bottom left, Executive Aviation, revenues of \$167 million in Third Quarter, accumulated \$580m. As typically, as we said before in this business, we expect to see growing revenues in the Fourth Quarter as typically as we have been before.

And in the last part of this page, at the bottom right, the Defense and Security, revenues of \$259 million in the Third Quarter, accumulated \$757 million in the year, expectations for stable performance in the last quarter.

So, we then conclude the revenues in this quarter and year to date.

Let's turn to next page, page eight. And you see the revenues by segment. And the second column from the right, the year-to-date 2012, with revenues of \$4.28 billion accumulated in the year, we see here the major part is presented by the Commercial Aviation and the Defense, as we indicated before, with a good performance in the year-to-date position.

And we see that the Executive business, we expect it to recover this position because of the seasonality of the business. We expect to see them growing participation, as we see, the whole year, which we can confirm in the column on the right, which is the expectation

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for the year, having the major part coming still from the Commercial Aviation. But we'll also see a growing participation on the Executive Aviation. So, we are confirming that we expect to meet the guidance in the range of \$5.8 billion to \$6.2 billion for the year.

Page nine, as we announced early this month, the backlog accounted for \$12.4 billion in the Third Quarter, reflects the commercial activity since the end of the last quarter, where we leave[ph] the information of \$12.9b.

Next page, page 10, in terms of net revenues and gross margin, revenues for the Third Quarter were \$1.4b, accumulated \$4.3b. We've been showing a growing margin, especially in the Third Quarter. We had this positive margin of 25.3%. That is represented by basically the contribution of Defense, also the positive product mix.

And the other effects of the stimulus package also contributed here. But maybe you could say that maybe 1% of this margin would be specific for this stimulus package. The other is really representing good performance that we expect to make. We still expect to see this for the Fourth Quarter.

However, in the last quarters, as the Executive Aviation has a more higher participation, we expect the margin to suffer a little bit. But we're still meeting the targets that we've shown before.

Okay. The next page, page 11, in terms of the SG&A expenses, a total of \$170 million in the Third Quarter, it's lower compared to the previous quarter. But, as we indicated in the press release, there was a reclassification of personnel expenses that we took from here, \$9m. But, even then, there's still expressly a reduction that's coupled with the stimulus package impact, reflecting, of course, the efforts of the Company in terms of controlling costs and reducing those costs. So, we still expect to see the same for the following quarter, still probably similar levels for the Fourth Quarter of this year.

Page 12, income from operations, what we see here reported \$101 million for the quarter. But this was impacted by the nonrecurring Chautauqua recognition agreement. If we exclude that item, we have here -- we would have \$143m. The reported margin of 7.2% would be 10.2%. The accumulated reported margin of 9% in the year without the Chautauqua would be 10% for the nine months of this year. So, we still see a strong recurring operating margin and, again, confident that we could meet the guidance range at the end of the year.

Next page, page 13, in terms of EBITDA, total reported \$166 million would be \$208 million without the Chautauqua effect. We reported 11.8% EBITDA margin that would be 14.9% if we take out the impacts of the Chautauqua. We're okay in terms of meeting the guidance for sure in terms of the EBITDA for the year.

Next page, page 14, net income, \$65 million for the Third Quarter, accumulated \$235 million for the year, that includes the impact of the recalculation of the income tax. And the margin of 4.6% in the quarter.

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Moving next page, page 15, in terms of inventory and free cash flow, reported inventories of \$2.6 billion in the Third Quarter, stable in relation to the previous quarter. That reflects the typical seasonality of the business. We expect to see this level of inventories reducing and closing the year of 2012 with similar levels than we had in the end of last year, about \$2.3 billion of inventory amount.

On the right side of the presentation, in terms of free cash flow, the Third Quarter, we had free cash flow from operations negative \$30m. That's because of the seasonality of the business. We expect to see an improvement in the Fourth Quarter. And also, the cash remitted for investments are associated to the plant in Portugal and also to the Legacy 450 and 500 planes.

So, again, we expect to see in terms of the free cash flow generation improvement in the Fourth Quarter of this year.

Page 16, in terms of investments, total year to date of \$360m. If you compare to the outlook that we gave for 2012 of \$650m, we don't expect that that level will be achieved. Probably, it will be \$100 million below that level, which would be reflecting basically the impact of the dollar with the real and also revision and the optimization of investment schedule.

Just to comment that the development investment is more basically be associated to the Legacy 450 and 500.

Last page now, page 17, in terms of indebtedness profile and net cash, we had a total debt as of the end of the quarter of \$2.1 billion and the net cash of \$123m. The profile of the debt is still comfortable. We are showing an average term of six years, which is comfortable. Also, the breakdown between short and long term has improved. We see 17% of the debt in short term and 83% in the long term, which is comfortable and in line with the expectation of the Company, especially because of the profile of the debt.

Basically, this is the summation of financial information. I think now we turn back to the questions of the participants. Thank you.

Questions And Answers

Operator

(Operator Instructions) Our first question comes from Ron Epstein of Bank of America. Please go ahead.

Q - Ron Epstein {BIO 15893287 <GO>}

Yes. Good morning.

A - Frederico Curado {BIO 2004589 <GO>}

Morning, Ron.

Q - Ron Epstein {BIO 15893287 <GO>}

Just maybe two quick questions. When we think about Chautauqua and what's going on there, do you expect this to be the end of it, or do you expect there to be a tail of other things related to Chautauqua?

A - Frederico Curado {BIO 2004589 <GO>}

Yes, Ron, with this impairment that we are undertaking is our best assessments of what would be the impact to us. We certainly believe that Chautauqua needs restructuring, which involves many stakeholders, not only Embraer. They will have a much better chance to continue to be one of the major regional airlines in the United States. So, we're confident that the worst is behind us in that story. And we're optimistic that Chautauqua and its public as a whole, will play an important role the next few years in the routine of the regional jets in the United States.

Q - Ron Epstein {BIO 15893287 <GO>}

Okay. And then maybe a follow on to that, when we think about the refueling in the United States, can you give us an update on maybe where some of the sales campaigns are and any feeling on timing when things might start to happen? There's a lot of investor anticipation around what's going to happen in the US. So, if there's any additional color or detail you could give us in terms of sales campaigns and things like that, that would be great.

A - Frederico Curado {BIO 2004589 <GO>}

Okay. Well, there is not much beyond what we have discussed just a few years ago in Melbourne, Florida, in our Investors Day. I think we continue to believe that the one campaign that may have an outcome this year is Delta Airlines. Of course, we're not in a position to say whether or not this is going to happen. But, there's clearly a rhythm[ph] in that campaign.

And there is a growing activity. This is definitely tangible. There's a growing activity with majors and regional affiliates, not clear for us yet how each player will strategize their refueling, whether directly by main line or the regional affiliates will be the ones actually procuring the aircraft is not clear.

Delta is feeling the force[ph] of their own procurement. But the other airlines (inaudible) the level of activity is growing. So, as Paulo[ph] suggested, probably 2013, there'll be a much more intense activity and maybe -- I'll say probably some decisions, some actual facts happening in that regard.

Q - Ron Epstein {BIO 15893287 <GO>}

Okay. And then maybe just one last question, on the Legacy 500, I know it's just been a couple weeks since the meeting in Melbourne. But any updates on that program? Is everything on track to fly when you anticipate and so on?

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A - Frederico Curado {BIO 2004589 <GO>}

Yes, there is, Ron, some -- every day, we get more and more confidence. We actually present the -- we had a session with -- the airplane is pretty complete for flight. So, it's now in the final stage of making sure that the (inaudible) of flight clears the aircraft for flight. We are absolutely convinced that this flight will happen before the end of the year, as we have said. So, I think that well covered now.

Q - Ron Epstein {BIO 15893287 <GO>}

Great. Super. Thank you, very much.

A - Frederico Curado {BIO 2004589 <GO>}

Thank you.

Operator

Our next question comes from Peter Skibitski of Drexel Hamilton. Please go ahead.

Q - Peter Skibitski {BIO 6760095 <GO>}

Good morning, guys. I guess, Filippo, I just wanted to make sure I understood you correctly. On Sisfron, I think you said you expect to generate \$400 million in revenue over three years. Is that accurate?

A - Jose Filippo {BIO 1726218 <GO>}

Yes. Yes, that's the forecast for the program, which will be within the next few years, \$400m, correct.

Q - Peter Skibitski {BIO 6760095 <GO>}

Okay. Thank you. Very helpful. And then on gross margin, I know you touched on this a bit. I had a little bit of trouble hearing but can you quantify some of the items that influenced gross margin for the quarter? I know you mentioned defense being a larger part of the sales mix. But anything with regard to the product mix that you mentioned? And maybe could you quantify the impact of the stimulus and the real depreciation?

A - Jose Filippo {BIO 1726218 <GO>}

Yes, the stimulus package is about 1% on this margin.

Q - Peter Skibitski {BIO 6760095 <GO>}

Okay. And then with regard to product mix?

A - Jose Filippo {BIO 1726218 <GO>}

The product mix means more E-Jets and Executive Aviation, the larger jets.

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Q - Peter Skibitski {BIO 6760095 <GO>}

Okay.

A - Frederico Curado {BIO 2004589 <GO>}

Yes, we expect in the Fourth Quarter, we expect a softening of the gross margin because we tend to have a significantly higher delivery of business jets. And not only the large ones. But also the small ones. And if E-Jets is probably stable. So I think the product mix in the Third Quarter was particularly favorable. And we probably will not see that same thing happening in the Fourth Quarter.

The stimulus package, of course, is still out there and its positive contribution (technical difficulty).

Q - Peter Skibitski {BIO 6760095 <GO>}

Okay. And last question, I wanted to ask you a little bit about services. I had a few questions. But, I guess the one I'll ask is that, for your Second Quarter, actually, Defense Services was reported at \$68.9m. And it looks like this quarter you've reclassified it. It was reported at \$51.4 million this quarter. I'm just wondering what the nature of the reclassification was.

A - Frederico Curado {BIO 2004589 <GO>}

(technical difficulty).

A - Luciano Froes {BIO 17907241 <GO>}

Hi, Pete, this is Luciano. Actually, the Defense year to date remains pretty much on track with regards to the forecast, representing about 20% of the guidance that we gave an outlook. So, today, year to date, it's at around \$147 million in terms of total services for the Defense business. And so, we expect that to remain pretty much on track in terms of the overall contribution for the revenues of the business.

And furthermore, on a consolidated basis, when we look at services, we had approximately \$545 million in total services revenue. And so, that -- we expect, of course, given the addition of services in the Fourth Quarter, we'll be pretty much on track in terms of the guidance for that component. So, that's pretty much the element of services for Defense.

Q - Peter Skibitski {BIO 6760095 <GO>}

Okay. Thanks very much, guys.

A - Frederico Curado {BIO 2004589 <GO>}

Thank you.

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Our next question comes from Myles Walton of Deutsche Bank. Please go ahead.

Q - Amit Mehrotra {BIO 15408970 <GO>}

Hi there. Thanks for taking my question. It's Amit Mehrotra here for Myles Walton. First question is on admin costs that you've put into the other expense category. The release talked about this being temporary. But, when do you really think these expenses will go away? And what's the quarterly run rate we should expect in that line over the next few quarters?

A - Frederico Curado {BIO 2004589 <GO>}

The other expenses, we have, of course, the Chautauqua recognition in the other expenses this quarter. And we had the \$9 million of the operational expenses that was reclassified to others just this quarter. But, it's about \$2 million each quarter.

Q - Amit Mehrotra {BIO 15408970 <GO>}

Okay.

A - Frederico Curado {BIO 2004589 <GO>}

So, that -- we had a natural improvement of about \$10 million in the quarter. But, that's the natural improvement, plus efficiency, less favorable -- less expenses. The actual improvement was about \$10m.

Q - Amit Mehrotra {BIO 15408970 <GO>}

Okay. And just can you give us some color on the future impact of the stimulus? If I heard you correctly, I think it was said that the stimulus helped the margin, the gross margin by 1percentage point. Did I hear that correctly? And is that the run rate in subsequent quarters, or should we see some increase as we move into future quarters?

A - Frederico Curado {BIO 2004589 <GO>}

Yes, this impact was the stocking of the payroll impact. So, next year, we still think about \$100 million could be the whole impact. This could be considered as the stimulus package impact for next year.

Q - Amit Mehrotra {BIO 15408970 <GO>}

Okay. And just last question, could you give us a little bit more color on the backlog? Can you give us maybe backlog by segment or the change in the backlog within each segment? It looked like there was some stabilization in the executive aviation segment, wanted to see what was driving that, given some other players were reporting relatively meaningful declines. Is this more Legacy 500, 450 entering the backlog or a reduction in cancelations or both? What's really driving that?

A - Frederico Curado {BIO 2004589 <GO>}

In terms of the backlog, we could break down basically something close to 50% is Commercial, 30% Executive. And 20% Defense.

Q - Amit Mehrotra {BIO 15408970 <GO>}

Okay. And that would imply a \$3.7 billion backlog in Executive Aviation, which is a pretty nice sequential uptick from the Second Quarter. So, can you just give a little bit more color in terms of what's driving that?

A - Luciano Froes {BIO 17907241 <GO>}

Hi, Amit. This is Luciano here. So, just to complement, yes, I mean, we did have some sales activities in the Executive Aviation segment during the quarter. And actually, the book to bill, the net book to bill for that segment was positive. So, it was above 1 and in the quarter. And so, that was a contributor to the final backlog as you see there.

Q - Amit Mehrotra {BIO 15408970 <GO>}

Okay. All right. Thanks a lot, guys.

Operator

Our next question comes from Noah Poponak of Goldman Sachs. Please go ahead.

Q - Noah Poponak {BIO 16071528 <GO>}

Hi. Good morning, everybody.

A - Frederico Curado {BIO 2004589 <GO>}

Good morning.

Q - Noah Poponak {BIO 16071528 <GO>}

Fred, your -- in the Commercial business, the backlog has declined several quarters in a row. And your backlog coverage relative to current production is at one of the smaller levels it's ever been at. But on the other hand, you have all of these large, outstanding potential wins in the US. So it seems fairly binary in terms of where production goes from here. How do you think about that? How do you plan the business for that?

And presumably this deep into 2012 you have to be starting your 2013 production plans. Is there any way to bracket for us where production goes if you don't get any of those orders, or you get a smaller amount than you thought, versus how much higher production goes if you get a significant share on time out of that order flow?

A - Frederico Curado {BIO 2004589 <GO>}

Sure, Noah. We -- well, starting with the (inaudible) just a -- and this is clearly our number one point of attention and effort and (inaudible). But what you have to have in mind is that we do have a sound product line. We -- between today and by the time we give our

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guidance for 2013 early next year, sometime around February, I guess, we'll -- we are still shooting for a stable production of the E-Jets next year. So we will take around the same, about the same production rate. And we do have time to make -- to keep some of those campaigns going on which are not only in the United States but the large ones we have. But we have activities around the world.

So at this stage I think the best that we can still have is a steady E-Jets production for next year. Obviously if we do not -- we do have open to us for the back end of next year. So that -- those have to materialize in the next, say, well, six months or so. I don't see much -- I don't see actually much signs potential for what we doing this year. And the risk is seeing a little bit of a downside vis-a-vis the production levels this year. Again, we remain still confident that that will not happen; we'll be able to sustain production levels where they are. And we will know that within the next four to six months.

Q - Noah Poponak {BIO 16071528 <GO>}

Okay, that's helpful. And then just one other question on the business jet side. It looks like you're reiterating the 2012 revenue forecast there. But I can get into the bottom of that range with a unit number that's relatively shy of your unit forecast. So I just wondered if you could speak to the 75 to 85 light and 50 to 20 large, if that's still the expectation there?

A - Frederico Curado {BIO 2004589 <GO>}

Yes. Luciano will help me here with (multiple speakers).

A - Luciano Froes {BIO 17907241 <GO>}

75 (technical difficulty)

A - Frederico Curado {BIO 2004589 <GO>}

(multiple speakers) and yes. I think we're going to get there, yes. We had an active -- seen already active quarter for those. New configurations and etc. But like unfortunately this has been a trend for the last for this quarter or for the production[ph] in our assembly line and overtime, need for overtime, etc. The question is we give -- have a firm backlog, clearly that this quarter and we probably shall achieve our targets, both in revenues and quantities.

Q - Noah Poponak {BIO 16071528 <GO>}

Super. Thank you for taking my questions.

A - Frederico Curado {BIO 2004589 <GO>}

Thank you, Noah.

Operator

Our next question comes from Joe Nadol, JP Morgan. Please go ahead.

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Q - Unidentified Participant

Hi. Good morning. Actually it's Stephan for Joe this morning. I have a quick question about the margins. Just to clarify, was the stimulus in effect for the entire quarter? Or is there incremental benefit in Q4 relative to what you got in Q3?

A - Frederico Curado {BIO 2004589 <GO>}

We have a small incremental because it's starting now to improve this quarter but not major change. Could be possibly the same, pretty much the same for next quarter.

Q - Unidentified Participant

Okay. Okay. And then, Fred, can you talk about any changes in the skyline these days? Are you seeing -- for the E-Jets? Are you seeing much in the way of deferrals or shuffling in terms of when people want to take their deliveries?

A - Frederico Curado {BIO 2004589 <GO>}

You mean on commercial? Into commercial aircraft or business aircraft?

Q - Unidentified Participant

Yes, commercial.

A - Frederico Curado {BIO 2004589 <GO>}

No, I think we had some very specific situations earlier this year with the Korean[ph] airlines. We renegotiated that and actually were able to move some of their aircraft to the (inaudible) configuration. No, there is no trend to -- of postponements or deferrals at this stage. What we are going to have to do is to (inaudible) our skyline and make sure we remain in a position where we are.

Q - Unidentified Participant

Great, great. And then just a final question. Any additional thoughts on the Hawker situation now that the Superior deal has collapsed?

A - Frederico Curado {BIO 2004589 <GO>}

Not really. We -- I think I can say it's not totally surprising that those conversations collapsed. Hawker, it's a complex, I think a complex scale (inaudible). Again, our view is that some aspects are -- will have some value. Some have no value. The company as a whole as it has been performing, I don't see a reason why someone should believe that by changing management or doing something else, that situation will change. I don't think that will change. It's a complicated situation. It is not part of our strategy. We remain focused our organic growth and in the business jets, execution of what we already have to operate.

Q - Unidentified Participant

Okay. Okay, okay, thanks very much.

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A - Frederico Curado {BIO 2004589 <GO>}

Thank you.

Operator

Our next question comes from Nicolai Sebrell from Morgan Stanley. Please go ahead.

Q - Nicolai Sebrell {BIO 7321622 <GO>}

Hi, guys. Good morning. So two questions. First on the margin, it looked like this quarter, correct me if I'm wrong, ex the one-time item, EBIT margin of 10% or better. So is that sustainable? Do you see because of the changes in the FX, changes in some of the stimulus that there's a possibility for next year?

And then if you could just give any update on the E190, do you still plan to do an announcement on the re-engineing or rather details of that program early next year? What's the current timing on that? Thanks.

A - Frederico Curado {BIO 2004589 <GO>}

Yes, we have I think not only (inaudible) 10% margin, we had the stimulus package, we also have a favorable product mix. So I think it's probably over-optimistic to imagine that we are going to sustain that margin next year. But of course we are working hard. And we'll keep working hard to keep in the high single digits as a minimum area now. 9% is our target for this year. So we'll soon be able to provide you some clear guidance for 2013. 10% was I think a favorable combination of the health[ph] factors.

Due to the 190, the 190 re-engineing. We're on track for engine selection by year end. Final sprint with all three contenders. And so the program is moving on. We're increasing budgets for next year our investment, we already consider (inaudible) our investment a significantly higher amount for this program, which we will officially launch sometime around mid next year or so. But the principal[ph] path to determine[ph] is being followed and the next key decision we have to make, is the engine selection by year end. And the remaining key systems -- just always keeping in mind this aircraft. So this is a relatively easier exercise sometime within the first half of next year. So by mid of next year we should have all major suppliers aligned and the program will keep on track. Key targets for 2018 still ahead.

Q - Nicolai Sebrell {BIO 7321622 <GO>}

Okay. And thinking of it like a five; or six-year program, how does the CapEx vary? Is it mostly back-end loaded, or does the majority CapEx happen in the middle of the program, or -- what's the pattern of spending, normally?

A - Frederico Curado {BIO 2004589 <GO>}

This program tends --

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Q - Nicolai Sebrell {BIO 7321622 <GO>}

(multiple speakers) how to model the --

A - Frederico Curado {BIO 2004589 <GO>}

This program tends to be light on CapEx. This CapEx mainly including of course development costs, engineering costs. And CapEx, we have a typical profile, the last two, three years being the heavier. But the actual CapEx, industrial capacity and machinery and stuff and tooling, this probably will be relatively light because it's based on existing aircraft. Add to that of course the tooling for the wings. But the fuselage is fundamentally the same. And so the (inaudible) is the same. The factory, we have everything in place, even to construct the aircraft but there's no need to make any major modifications to our hangars. So it's going to be light as far fixed (technical difficulty).

Q - Nicolai Sebrell {BIO 7321622 <GO>}

Thanks a lot, it's helpful. Thank you.

A - Frederico Curado {BIO 2004589 <GO>}

Thank you.

Operator

Our next question comes from of Milan Posarac from Scotiabank. Please go ahead.

Q - Milan Posarac {BIO 21061140 <GO>}

Good morning, guys, just speaking for Turan Quettawala today. Just have a quick question about actually the used E-Jet market. I was wondering if you can comment on the state of that market? What levels are these aircraft out there in the used market? And are you seeing any more available for sale? And I'm wondering if you feel this is impacting in any way the orders for new jets coming off the line?

A - Frederico Curado {BIO 2004589 <GO>}

Well, I think -- I believe the fundament, let me start it this way. The fundamentals for the success of the E-Jets so far, they still are very valid fundamentals which is we have an optimized aircraft for (inaudible) call it 80 to 120 seats. And so we project rank[ph] the average cost per trip advantage against larger, narrow-bodied aircraft flying with empty seats. This cost per trip advantage is what has really made the commercial viability of the program, means (technical difficulty) airlines (inaudible) fly the aircraft (inaudible) years.

And of course as Airbus and Boeing as they have (inaudible) programs are advancing and as they come into service, this cost per trip advantage is reduced, which could pose a threat to the viability of the E-Jet. But this is exactly why we are also restoring this -- or keeping better, keeping this gap, this cost advantage by also re-engining and in our case also re-winging the -- the change of wing is going to happen year with (technical difficulty).

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So this is the macro strategy. We are in the moment, where Boeing and Airbus have significantly raised their production already[ph]. And although there's no direct competition the 737 and (inaudible) E-Jets, no direct competition, an excess in the market of course affects everyone. So I think we are leading[ph] to (inaudible). The good news is that we have leading companies in our portfolio and a much larger portion of (inaudible) which is an indication of our sales record.

So I think we're going to be okay in accommodation[ph]. And one potential upside to everything I've said is the resurgence of the regional airlines in the United States, which has less to do with all the rationale I've just described, it has more to do with (inaudible) cycles. So it's more likely that the demand that comes in cycles. And when it comes, comes in big numbers.

But in future having airplanes that are larger, main line (technical difficulty).

Q - Milan Posarac {BIO 21061140 <GO>}

Thank you.

Operator

Ladies and gentlemen, please remain on the line. (Operator Instructions) Ladies and gentlemen, our next question comes from Stephen Trent of Citi. Please go ahead.

Q - Stephen Trent {BIO 5581382 <GO>}

Hi. Good morning, guys. And thanks for taking my questions. Just two from me, very quickly. The first is looking at what happened with the Chautauqua. We saw the American Airlines in the Fourth Quarter also has an impact on your numbers from the financial guarantees. Are you guys comfortable that this is the end? Or could we see some risk going down the road as players, like ExpressJet perhaps, order larger jets as they're getting rid of their 50-seaters? Just wondering what your thoughts are on that?

A - Frederico Curado {BIO 2004589 <GO>}

In relation to the impact of Chautauqua, we are -- we think that the recognition that was made in this quarter is enough as we're finalizing the documentation and the negotiations. So we don't think there's going to be any additional impact regarding the effects of the cancel that we have. We keep the level just about \$600 million (inaudible) in the off-balance to reflect the impact of Chautauqua (inaudible) on the balance sheet will be just disclosed details as we understand we'll be able to sign the full agreement.

(Foreign Language)

Q - Stephen Trent {BIO 5581382 <GO>}

(Foreign Language)

A - Frederico Curado {BIO 2004589 <GO>}

So I think the (inaudible) market in the United States neither having a fairly easy ride now or collapsing, as many folks foresaw. But it's a combination of gradual and organized absorption of those airplanes in secondary market which then -- which clearly for example in (inaudible) where you have (inaudible).

So we are on the Chautauqua case -- the whole restructuring of Chautauqua is meant to keep the airline competitive and all the airplanes flying. So as it was partially the case in the American Airlines bankruptcy, in the American Airlines some airplanes are leaving the fleet, especially the smaller ones. The bulk of the fleet will be maintained as the (inaudible) costs are variable[ph]. The Chautauqua is a very similar exercise. So I think the industry, a little bit at a time here and there, it's organizing itself to have a smooth transition on (inaudible) 70 or 80 seats, the larger jets in the next several years. So we don't see a doomsday scenario. But of course have been -- I think everybody has had a little bit of pain in this (inaudible).

Q - Stephen Trent {BIO 5581382 <GO>}

Okay, thanks, Freddie. And just one very other -- one other quick question from me. If we look forward and the environment in Brazil and the extent that we see perhaps higher medium-term inflation and perhaps some return to the so-called macro potential measures, do you see any of the defense-related programs at risk of being delayed or shrunk down, maybe not Sisfron. But maybe the jet fighter contract? Or what are your thoughts there?

A - Frederico Curado {BIO 2004589 <GO>}

I think -- well, Filippo can also add. But we -- I'm personally optimistic that we will have some higher growth next year. Some early signs are already there. Mrs. Rousseff, she inherited a -- let's say a concerning potential deficit when she took office. And she really took a very strict, a very strong -- she took very strong actions to make sure that the fiscal discipline is maintained. This was early last year. So almost two years ago. And as a result of that, the market quality kept, was kept very healthy. But the economic development and the economic facility did not grow as it did in 2010. So this is probably would be 1%, 1.5%, which is relatively low for Brazil.

She's trying hard to incentivize the Brazilian industry as a whole. And in exports. So the activity -- and obviously the social inclusion, which has been one of the pillars of this development. I believe and I think a lot of people here in Brazil believe that we will grow at a higher rate next year. That's going to help, that's my clear impression[ph], that's going to help with the fiscal budget and the ability of the armed forces to maintain their acquisition in their key plans.

And simply about our side of the story. We are confident the KC-390s will be kept intact. We are confident that the Sisfron, for those programs, they are absolutely fundamental for the Brazilian national defense strategy. And I also, although the impact of fighter program for us is not as important as for example the KC-390. I also believe that Brazil will come to the conclusion, a positive conclusion in that program sometimes probably

early next year or first half of next year. But it's again a bit more an opinion, an observation from outside. I do not have any inside information.

But I do know that the air force just needs to replace the airplane because the Mirages will stop flying late next year and (inaudible) air force who had refurbished F-5s that we have been (inaudible). So this must be taken. And I believe will be taken within the next 12 months, hopefully earlier -- sooner rather than later.

Q - Stephen Trent {BIO 5581382 <GO>}

Okay, perfect. (Foreign Language)

A - Frederico Curado {BIO 2004589 <GO>}

(Foreign Language)

Q - Stephen Trent {BIO 5581382 <GO>}

(Foreign Language)

Operator

Our next question comes Carter Leake of BB&T Capital Markets. Please go ahead.

Q - Carter Leake {BIO 16268380 <GO>}

And I'm late to the call. So I apologize if this has been asked. On the Chautauqua deal, can you tell me how it relates to any reductions in residual value guarantees? For example, if Chautauqua were to subsequently default, what would -- could you maybe give some color on what would be the ultimate puts and takes with regard to FLDs, RBGs, etc?

A - Frederico Curado {BIO 2004589 <GO>}

Yes. What has been happening now is the agreement for a restructuring program of Chautauqua if it gets into default going forward there's going to be full impact because the situation we have today is the negotiation and just finalizing the details. And this is reflected in this amount. But we still have enough of guarantees in the balance for the total that was given when the sale was made.

Q - Carter Leake {BIO 16268380 <GO>}

I don't know if I caught all that. But did you -- did this allow you to reduce RBG exposure?

A - Frederico Curado {BIO 2004589 <GO>}

Yes. We reduced some of the exposure, definitely.

Q - Carter Leake {BIO 16268380 <GO>}

But it was not a buyout of your exposure?

A - Frederico Curado {BIO 2004589 <GO>}

No, no, it was not.

Q - Carter Leake {BIO 16268380 <GO>}

And then the only follow-up would be, do you see, I assume this is some type of leap[ph] subsidy that lowers their operating cost and you probably spelled that out. Do you see any risk as an aircraft manufacturer in getting that deep into your customer's operating economics, after the sale?

A - Frederico Curado {BIO 2004589 <GO>}

Not sure I -- maybe I misunderstand the question. Could you -- ?

Q - Carter Leake {BIO 16268380 <GO>}

Well, would you do -- I guess I would say is -- is this something that you might do for someone else? If an airline, say, got into trouble. And obviously lower operating costs, for example, is this something that you would consider in other scenarios with other airlines?

A - Frederico Curado {BIO 2004589 <GO>}

Hopefully not. But of course, we do have, I think it was \$600 million in our off balance. But we have notes. This would be our -- let's say, for potential total exposure if everything goes wrong. We -- our three -- let's put it this way, we have three large fleets of ERJ 145s out there. One is with American Airlines, another one is with Chautauqua Republic and another one is with Continental Express, now it's (inaudible) fly for Continental Airlines, which -- Continental has -- is responsible for the assets. So we do not anticipate at this stage anything beyond that we have done. I think that's where Chautauqua as Filippo said, it was a much better exercise for everybody to do this voluntary restructuring then to really wait and see for potentially a more strange situation.

Q - Carter Leake {BIO 16268380 <GO>}

Thank you.

Operator

(Operator Instructions) Our next question comes from Bruno Amorim of Banco Santander. Please go ahead.

Q - Pedro Balcao {BIO 3321352 <GO>}

Yes, hello. This is actually Pedro Balcao from Santander. Good morning. Regarding commercial aviation, what is the level of revenues for 2013 that you have guaranteed now by the current backlog?

And really, why are you so confident on having a level of revenues in 2013 in line with that of 2012, taking into account that current level of backlog? Thank you.

A - Frederico Curado {BIO 2004589 <GO>}

This is a management evaluation. In the past we have -- we initiated years in the past with much lower backlog than we have now. So we see a reduction in the backlog, than our backlog on a relative basis was in those years, not recently but in the past, was not as reversed as we have now. So, our confidence of course is based on our belief that we achieve a few sales in next few months. And this will be (inaudible) really sufficient to sustain our production. Having said also if defense keeps growing and so does executive jets as a whole, the Company has now a lot of other inputs as well. So I don't know what else I can tell you other than we are working towards making that production airline -- production rate stable.

Q - Pedro Balcao {BIO 3321352 <GO>}

Thank you for that. Can you give me an idea of exactly what is the level of revenues for next year that is guaranteed now at the commercial aviation segment, taking into account the current backlog? Thank you.

A - Frederico Curado {BIO 2004589 <GO>}

No, unfortunately no. And I don't think anybody discloses that. We have specific -- it's done -- we have a guidance for this year, we have a guidance for next year -- no, in February. And I don't think anybody discloses detailed guidelines product line. Sorry.

Q - Pedro Balcao {BIO 3321352 <GO>}

Okay, thank you.

Operator

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

A - Frederico Curado {BIO 2004589 <GO>}

Just to thank, everyone, for the attention and hope to see you soon. And have a good week. And all the best. Bye.

Operator

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

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