

Q2 2014 Earnings Call

Company Participants

- Frederico Pinheiro Fleury Curado, President & Chief Executive Officer
- José Antônio de Almeida Filippo, Executive Vice President Finance and Investor Relations Embraer
- Luciano Froes, Head of Investor Relations

Other Participants

- Cai von Rumohr, Analyst
- Eduardo S. Couto, Analyst
- Joseph Nadol, Analyst
- Myles A. Walton, Analyst
- Noah Poponak, Analyst
- Peter John Skibitski, Analyst
- Ravi Jain, Analyst
- Ronald Jay Epstein, Analyst
- Stephen Trent, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen, and welcome to the audio conference call that will review Embraer's Second Quarter 2014 Results. Thank you for standing by.

At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions to participate will be given at that time. As a reminder, this conference is being recorded and webcasted at ri.embraer.com.br.

This conference call includes forward-looking statements or statements about events or circumstances which have not occurred. Embraer has based these forward-looking statements largely on its current expectations and projections about future events and financial trends affecting the business and its future financial performance.

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

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Embraer undertakes no obligations to update publicly or revise any forward-looking statements because of new information, future events or other factors. In light of these risks and uncertainties, the forward-looking events and circumstances discussed on this conference call might not occur. The company's actual results could differ substantially from those anticipated in the forward-looking statements.

Participants on today's conference call are Mr. Frederico Curado, President and CEO; Mr. José Filippó, Chief Financial Officer and IRO; and Mr. Luciano Froes, Director of Investor Relations.

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

José Antônio de Almeida Filippó

Okay, thank you. Good morning, everybody, and thanks for joining our second quarter 2014 earnings results teleconference. As usual, we'll go through the presentation and then we'll be ready to open for questions.

Let's start on page 3. Starting with the highlights of the businesses, and the first one, the Commercial Aviation business. We had a strong execution in the second quarter of 2014 with 29 deliveries, accounting for 43 E-Jets through the first half of 2014. Regarding new E-Jets operators, we added two new airlines, the Borajet from Turkish and the Royal Air Maroc in this quarter.

In relation to new aircraft sales, we have some good announcements, starting with our Aurigny Air Services with acquisition of 195 E-Jets. And also some good activity in the Chinese market with ICBC leasing and HNA Group, which included current generation and E2 sales, as well.

Moving to the next page, page 4, continuing sales announcements, highlighted for four deals. Trans States signed a deal for a 100 175-E2. Azul, with signed (3:43) LOI for 30 E195-E2 with 20 options. Fuji Dream Airlines placed an order for three E175 plus three options. And Azal from Azerbaijan, that ordered two additional E195. As far as demand status of the E2 family, we're happy with the current figures of 590 orders since the launch of the program that including 210 firm orders in this total.

Next page, page 5, Executive Jets highlights. Starting with deliveries, like the commercial segment, we also had a strong execution in the second quarter with 29 deliveries and a cumulative (4:46) of 49 aircraft deliveries in the 2014.

Some - also important milestones and recognition of our products. We have the Phenom family delivering its aircraft number 500 and also the Phenom's were elected as, Best of the Best, by Robb Report, another important information for this category. As far as product capability, we had the Phenom 300 receive a certification from EASA for steep-approach operation which opens up additional flight possibilities such as London City Airport.

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Moving to next page, Defense & Security highlights, we inaugurated the final assembly hangar for the KC-390 along with the contract signature for 28 units with Brazilian Air Force. In relation to the Brazilian Fighter Program, Embraer signed the MOU with Saab for this project, and this is tied to the agreement between Saab and the Brazilian government.

In relation to product maturity, our Xingu model celebrated 30 years of operation with the French Air Force and the French Navy. In relation to our controlled subsidiaries, Atech won two important contracts with Brazilian Federal Police and India government. And Visiona continue to advance in the satellites program with the conclusion of the preliminary design review phase.

Okay. Moving to the next page, in finalizing the company highlights, to mention two MOU recently signed with the first one with Embraer to assess reliability of critical systems in the oil and gas industry, possibilities of having contracts in this segment. And also the announcement that Embraer and Boeing signed the MOU for implementing sustainable biofuel R&D center in Brazil.

With that, we're now moving into the financial information and results. We move to page 9, starting with the backlog information. Slight reduction compared with the first quarter, reflecting the strong execution in the quarter. But it is important to recall that part of the sales that was informed in the previous pages will be included in the backlog in the following quarters.

Next page, page 10, as far as delivery - deliveries we already mentioned that we had a total of 58 deliveries in the second quarter; 29 in Commercial Aviation; and another the same amount in Executive Jets broken by 22 light jets and 7 large jets. We are maintaining our guidance for the year as we expect a more balanced profile between the first and second semester.

Next page, page 11, as far as revenue by segment, reflecting the good deliveries and performance all business segments showed growth in the second quarter compared to last year. We had by business \$972 million in the second quarter for Commercial Aviation, \$421 million in Executive Jets business, and \$357 million in Defense & Security, almost \$1.8 billion in the second quarter.

Specifically in the Defense & Security segment, we saw slight reduction in revenues compared to the first quarter in line with our indication and guidance. And by that, we reaffirm our revenue guidance by segment for 2014.

Next page, page 12, in terms of consolidated net revenues, we reached \$3 billion in the first semester of 2014, BRL 6.8 billion. We believe we are well positioned to meet our guidance for the full year, which represents \$6.0 billion to \$6.5 billion for 2014.

Next page. In relation to operating expenses, we reported \$168 million SG&A expenses in the second quarter, accumulating \$308 million for the semester. The slight increase from the first quarter is in line with our indication given in the first quarter when we announced

the earnings. It's important to note that the year-to-date SG&A as a percentage of sales is approximately 10%. Operating expenses continues to be one of our main focus items in terms of management and cost control.

Next page. In relation to operating income, in the second quarter we had \$187 million operating profit with a 10.6% margin. For the first semester, operating income was \$279 million with a 9.3% margin. Once again, we expect a more balanced first and second semester, and we are maintaining our guidance figures for the year, which represents a range of \$540 million to \$620 million in terms of EBIT, and margin range between 9% and 9.5%.

Next page. As far as EBITDA, reflecting the previous operating figures, we reached \$261 million in the second quarter with a 14.8% margin and \$412 million in the first half with a 13.7% margin. Also, for EBITDA, our guidance remains unchanged for the years to the range of \$780 million to \$910 million, with a margin between 13% to 14%.

Page 16, next page. As far as net income, again reflecting the good performance, we reported a net profit of \$143 million in the second quarter with a 8.1% margin. For the first six months of 2014, the company reported a total of net profit of \$254 million and an 8.5% net margin.

In page 17, next page. In relation to inventories, we reported a total of \$2.4 billion in the end of the second quarter, slightly below the figures for the same period of last year and also being monitored very close, which is key for our working capital management.

In page 18, regarding free cash flow, we had an outflow of \$150 million in the second quarter and \$554 million accumulated year-to-date. One of the primary reason for this result was the increase of approximately \$250 million in accounts receivable, mainly related to defense contracts. Of this \$250 million, \$150 million was already received in the very first days of July. The balance we expect to be received in the second half of the year. With that being said, we are maintaining our free cash flow guidance of low-double digit for the year.

Next page, page 19. As far as investments, we had a total of \$128 million year-to-date, broken by \$21 million for research, \$59 million for development and \$48 million for CapEx. For develop, it's good to report that this figure is net of supply contribution. Although we expect high investments in the second half of the year, we see some potential to end the year slightly below the \$300 million for development. We had a guidance of \$220 million.

For research, we see a similar trend. And with regards of CapEx, that should be ramping up in the remaining of the year. But summing up all of this information, we are maintaining our investment outlook for 2014 of the total of \$650 million.

Next page, in finalizing this presentation, in relation to the company capital structure, page 20. We reported a net debt figure of \$114 million in the end of the second quarter, largely explained by the cash flow performance, as discussed. Regarding our financial debt, we

still show a very comfortable profile, with only 4% maturing in the next 12 months an average maturity of 5.7 years, in line with our business cycle.

With that, we conclude the presentation. We're now ready for the questions. Thank you.

Q&A

Operator

Thank you. Our first question is from Cai von Rumohr of Cowen & Company. You may begin.

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

Yes. Thank you very much. So, following the good orders you got at Farnborough and just after, maybe you could give us some color on your comfort with your ability to hold production of the RJ line until you bridge to the E2?

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

Thank you, Cai. This is Fred. Well, there's no real change from last quarter. We remain comfortable. As you may have seen, the order we had from Hainan Airlines, a large operator of 190s, 40 aircraft, have been 20 existing E1s (16:28) and 20 new ones, I think re-enforces our theory. It's a good example of our theory that there is demand for aircraft right now. And there is demand for, of course, next-generation aircraft down the road. And the commonality factor will play an important role in that extent. So we remain comfortable. So far, so good.

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

Can you give us some color in terms of how far you're sold out, or how much is sold of 2015 and 2016, or where you still have slots that you need to fill?

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

Qualitatively, 2015 is looking good. We still have a few slots to fill, but we do not anticipate any issues for 2015. And 2016 looks certainly much better than what we had maybe a year or two years ago. And keep in mind that we do expect some activity in larger quantities in United States for next year for deliveries in 2016, 2017 and 2018. So, yeah, that's where we are.

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

And then, a quick one on other expenses. It was \$19 million in the quarter. I just jumped onto the call, but can you give us a little color in terms of what was in there and sort of what you expect in that line item for the year?

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

Luciano, can you...

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A - Luciano Froes {BIO 17907241 <GO>}

Yeah, so hi Cai, this is Luciano. So, yeah, others was pretty stable, slightly down when compared to the same quarter last year, right. So we had given indication, this line should hover at around the mid-teens, so around \$15 million or so as an expense in the quarter. Note that the reduction and cancellation fees that we saw from previous years, given the Executive Jet's environment, that also translated more to, again, this line being balanced at this level of expense. So that's what you can plan for that line.

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

Thank you very much.

A - Luciano Froes {BIO 17907241 <GO>}

Sure.

Operator

Thank you. Our next question is from Joe Nadol of JPMorgan. You may begin.

Q - Joseph Nadol {BIO 3056499 <GO>}

Hi. Good morning, guys.

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

Good morning, Joe.

Q - Joseph Nadol {BIO 3056499 <GO>}

Hi. So, first off, I was wondering if you could provide us with the segment operating margins?

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

Sure. Let me just - yeah, in rough numbers Commercial Aviation, for the quarter around, just a little bit north of 11%, Executive Aviation about 8.5%, Defense & Security about 9.5%, there is some others which is small ancillary revenues. So this is pretty much the breakdown.

Q - Joseph Nadol {BIO 3056499 <GO>}

Okay. That's much more even balanced than you had last quarter. I was wondering in particular on the executive side, as you look quarter-to-quarter, was the big improvement volume, was it price, just if could make the comparison and talk a little bit about the business jet environment?

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

Yeah, I think it's a combination of volume and mix.

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Q - Joseph Nadol {BIO 3056499 <GO>}

And more broadly speaking, what are you seeing in the market right now, the business jet demand?

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

Well, we have no material change, no fundamental change from what we saw last quarter. Market has not rebounded yet. Some softening in emerging markets, I must remark. Nothing that I think changes fundamental in the fundamentals of the potential demand, but there has been some softness in China, for example, and in Brazil. Those two - those are the markets, very important markets for any OEM. But again, I think they're more temporary. That's the way we see it right now. So, no fundamental change.

In the U.S., U.S. remains slow, catching up, as we mentioned in our last conversation. So, there's some good news and there is some more balancing now in the emerging markets. The U.S. is getting stronger. So I think, overall, pretty much the same picture.

Q - Joseph Nadol {BIO 3056499 <GO>}

Fred, just one more question on that. You mentioned the emerging market a little softer. You think it's temporary. Is that across your product line, or is that at the high end or the low end specifically?

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

I think it's more - actually it's the direct consequence. Well, I probably have two different answers. In Brazil, it's part of the whole macroeconomic scenario, some uncertainty. We have elections coming up in a few months. So it's not only airplanes, it's not only high or lower segments, it's across all economy. So the reason is caution, let's say a sentiment.

In China, I think the question is much more on some question about luxury items in general. So, I don't think it affects a specific segment, affects business jet, affect yachts. So there is - in China there is a kind of sentiment now about the luxury which everybody whom I talk with think that, yeah, there will be an impact in the short term, but the demand is - the potential demand, the outlook is so strong that there is simply no way that this thing will - is there forever. So, how long that's going wash out, I don't know. But those are the two main trends that we see in those two markets.

Q - Joseph Nadol {BIO 3056499 <GO>}

Okay. And then just one more, your margin, year-to-date is 9.3%, I believe. The EBIT margin usually is stronger in the second half as the volume goes up. So your guidance looks pretty abundantly conservative at this point. What would you highlight as - I know it's only Q2 here and anything can happen, but what would you highlight as the risks that has prevented you from raising the guidance here?

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

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Joe, you may recall that, we have mentioned several times we have been trying very much to (23:30) have a better balance between the first and second half. I mean, I would love to have, like, quarters which are very close to each other as far as our revenues and results, et cetera. So, not much volatility. We are not there yet. So, we still see some variations from quarter-to-quarter.

So, having said that, in 2014, we do not expect, for example, what we saw last year, when we had the first significantly stronger second quarter – I mean, second half compared to the first half. So, we have a more balanced year. That's why we have not revised that upwards, our guidance.

We do expect equal or better path the next half, of course, to get to our numbers. Probably more concentrated – not probably, certainly more concentrated in the last quarter. So, last quarter will be certainly stronger than the third quarter. But at this stage, I think I probably could say that, we don't see much downwards or downside risk. The best assessment we have is delivering the numbers, some upside risks maybe. We're not at all in a position to revise our guidance. So, it's conservatively good, I think, at this stage.

Q - Joseph Nadol {BIO 3056499 <GO>}

Okay. Thank you.

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

Thank you, Joe.

Operator

Thank you. Our next question is from Noah Poponak of Goldman Sachs. You may begin.

Q - Noah Poponak {BIO 16071528 <GO>}

Hi. Good morning, everyone.

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

Hello, Noah.

Q - Noah Poponak {BIO 16071528 <GO>}

Fred, the company sort of keeps beating margin expectations on the P&L, but missing free cash flow expectations on the cash flow statement. I hear what you said on accounts receivable in the quarter, and I understand the business is pretty lumpy from a working capital and CapEx investment perspective. But just if I take a step back, big picture, free cash conversion has been pretty weak, going on four years in a row now. I just wondered if you could talk about how much you're looking at that? How much it concerns you? How much you're trying to change it? And what you can do to change it?

And to the extent that you can talk about at least the big working capital and CapEx items in 2015/2016, so that we can see how cash progresses as we move forward that would be really helpful.

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

Thank you, Noah. Very, very good question. We are certainly, as I think to your question last quarter - maybe it was wrong (26:24) I don't remember, or Joe's. We absolutely look at cash as one of our key performance indicators. I mean, we did have this, let's call a literally abnormal situation where \$150 million which we did expect to be received in the last quarter, they were paid in the first days of July. So we should have broken even on the quarter.

And this \$250 million, if you compare the position of our year-end 2013 to where we are now or to the second quarter, this \$250 million, which - I mean, they should have been converted from accounts receivable to cash. And that would pretty much put us in line with our planning to deliver our expected figures of breakeven at the end of the year or slightly positive. I think single - I mean, low-double digit is our outlook.

I think it's quite an achievement. Though we have just taken into account, we are IFRS and we are developing a significant quantity of programs in parallel. So, for the volume of investment that we have, we must look at Embraer in a more, let's say, longer cycle. If you're looking for, let's say, a classic one-to-one cash conversion ratio. We are in a period where we are investing heavily in all three of our businesses, in business jets with two new models just a few days from certification, the other one next year. We have the E2, of course, it's a big investment, and the KC-390 as well, and several other smaller programs.

So, I think if we are able to deliver our slightly positive free cash flow at the year-end, with all the investments that we have been endeavoring, I think is a - we see it's a very solid results as far as cash. We really have to be careful about this accounts receivable, so we do not really get this out of control. So, I think that's where our focus is as far as cash.

Q - Noah Poponak {BIO 16071528 <GO>}

Okay. I mean, our 2015 and 2016 conversion likely to be better because there's little bit of a gap between what you've been doing in the executive jet business and the timing of E2 investments, or E2 two investments earlier than that suggests, plus you still have stuff going on in the defense segment, or is it just too early to tell?

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

It's early to tell, Noah. A little bit early. Fundamentally, we are already engaging. The engineering resources we are freeing from executive are being engaged in the E2. And so, it's a very respectful ramp-up as far as engineering resources. So in a very preliminary and very qualitative outlook, I don't see any fundamental change. But, of course, as we refine the numbers towards year-end, we're going to have a better picture.

Q - Noah Poponak {BIO 16071528 <GO>}

Okay. And then, just one other question I had in the commercial jet business. I was reading some press, over the past few days it's been out on the Brazilian government putting out some more details on our regional aviation development program. I actually haven't heard you guys discuss that a ton in the past. Is that something that can actually move the needle for your order book over the next 6 months to 18 months, or what are you seeing coming out of that?

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

Moving the needle, yeah, I mean, if the program is - I think it's a very important attempt to develop or, let's say, to recover what the country had in many years ago. The country in the - to go back 25 years ago, we had something like 250 cities to 300 cities with commercial service in Brazil. The number today is less than 50% of that, believe it or not. So the airports are out there. Nobody is flying to them.

And there's a billion (31:18) of reasons for that, but the question is the government has, of course, understood that regional aviation is, especially for Brazil with - a country with so large territory. And so, let's say, restricted infrastructure for roads and for railroads. So flying is really the way of people (31:37) be moved from place to place in Brazil. And keep in mind we have forest which is 50% of our territory. So it's a country which naturally deserves, or requires, aviation service.

So, by stimulating - really no flying, it's kind of a - you don't have to be very optimistic to see that if this thing really flies and looks like this government is very serious about it, we should be able to sell more aircraft, not only to Azul, but also to other airlines which currently do not operate regional jets. So did that move the needle? We hope so.

But we have to see how this thing is implemented. Several of these measures, several of the items, went to Congress. So they're not exclusive to the executive branch. So we have to see how fast Congress passes those pieces of legislation, or whatever they have to approve. But I think it's good news on the home front for us.

Q - Noah Poponak {BIO 16071528 <GO>}

Okay. All right. Thanks a lot.

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

Thank you.

Operator

Thank you. Our next question is from Pete Skibitski of Drexel Hamilton. You may begin.

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

Good morning, guys. Nice quarter.

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

Thank you, Pete.

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

Frederico, on the Legacy 500, is that on track for first delivery? Will we see one delivery in the third quarter?

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

Yeah, well first of all, we have to get the certification, which I said was by the end of July, which is today. We will missed it for a few days. I mean, everything is already delivered. Everything is already with our certification authority. I mean, we do expect, within any day, to have the certification of the Legacy 500. And as far as production, not sure, but I think it sounds right, about one or two delivered in the first quarter. I think about six airplanes we are planning to produce this quarter - this year, this second half.

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

Okay. That's great, that's great. And then, I want to ask couple more questions, one on the F-X2. It's just, some of the stuff in the press leads me to believe that maybe when the contract is finally signed off on, and it sounds like it's getting closer, that it could potentially be maybe much larger for you guys than maybe expectations a year or so ago? So, I was just wondering if you could tell us maybe what your expectations are for your cut of the F-X2 program, and maybe when do you think the contract will be finalized?

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

I think that's a very very good assessment. And as we now know a little bit more about the program and we have, of course - we have been interfacing with Saab very intensively in which role we should play. I think it's fair to say that today, we're probably seeing a larger role than what we saw before the contract was - before Saab was selected. The contract is still under negotiation between Saab and the Brazilian Air Force. So, they are the prime contractor.

The expectation is that the contract is signed before year-end. In parallel, we are working with Saab to define exactly what their role is. When we talk about eventually producing the airplanes in Brazil in our plants in Gavião Peixoto, this is certainly - this will bring higher potential revenue for the company. And also, Saab asked us to kind of coordinate, or manage, like a super first tier supplier to the program, organizing and coordinating all efforts in Brazil. This, of course, increases our role as well.

On top of those two points, there will be development for a new version of the airplane, which is the two-seater version of the airplane, in which we also were positively surprised that we probably have a higher participation in that development than what we foresaw some time ago. So, I think to your question, the answer is yes. We see a potential higher importance of the program for Embraer at this stage. As we go down the road until the end of the year, we're going to have some more precise understanding and figures, I suppose, about that.

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

That's great. Great news. And just one last question, if I could. I think I saw during the quarter some positive developments regarding extending the INSS, the payroll tax break. I'm wondering, is that your understanding as well? Is the payroll tax break going to be extended? And when do you think we'll know for sure about that?

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

Yes. It is. I mean, this bit (36:53) is, of course, not only for aerospace, for, I don't know, tens and tens of sectors, investor sectors in Brazil. This is really a, let's say, a need for the Brazilian industry in general and also for the service sector. The current government has stated that this is for good. It does depend on some Congressional confirmation, but we - we believe this is going to happen, even before the election.

So, it's something which is important for Brazil to be more competitive. Our industry is losing competitiveness, and this will certainly help the Brazilian industry, and also the service sector, to regain competitiveness. So we expect to be permanent.

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

Okay. And within the next two months?

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

Yeah. It's hard to put a deadline on anything in Congress. But I mean, this is what we have been hearing and reading recently.

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

That's great. Thanks very much.

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

Thank you.

Operator

Thank you. Our next question comes from Eduardo Couto of Morgan Stanley. You may begin.

Q - Eduardo S. Couto {BIO 15918458 <GO>}

Hi, Good morning, guys, and congratulations on the results. I have two questions from my side. First, on the regional aviation plan, Fred, just getting back to that a little bit, given the idea of the governments to launch this regional planning in Brazil, arriving the beginning of next year, can we assume that if the plan really goes through early next year we may see potential orders, even for the first generation of E-Jets, maybe from new customers in Brazil? Is it something possible, and also helping your transition right from the E1 to the E2?

And a second point, are you more comfortable now for the transition, given that you got some orders from China, there is this regional aviation plant in Brazil, so what's your view for the transition now vis-à-vis like a six months ago?

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

Okay. Thank you. We - yeah, so it's - as you know the package - some are - some actions will be implemented earlier and some will be implemented indirectly like simulation of regional flights out of (39:34) improve the demand for smaller aircraft. But several of the actions will depend on Congress. So, it's a very tough question to answer. Should we expect the order next six months, I think probably unlikely. I kind of stick to Noah's timeframe of 12 months to 18 months more likely, yes.

So, yeah, definitely, that may be a good tailwind for EI and for the transition, which by the way, we see as we advance. I mean, we remain comfortable. We are having orders of EIs. So, hence in 2015, we do expect some activity in United States in larger quantities for 175s replacing (40:32).

2015 looks good at this stage, 2016 looks good, actually two years out. And 2016 and 2017 and 2018, the bulk of that demand as we probably will start seeing some activity and more meaningful numbers in 2015. So far, so good. I mean, we're not fundamentally feeling different from what we felt last quarter. We feel good about it.

Q - Eduardo S. Couto {BIO 15918458 <GO>}

Okay. And just another point, Fred, regarding taxes in Brazil. There is the tax rebate for Brazilian exports, the Reintegra. I think the government is bringing it back. Can you comment a little bit about the potential impact from this tax rebate on exports for Embraer?

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

Sure. Again, as you know we are both based in Brazil. The tax system in Brazil are cumbersome and we I mean, (41:39). So the Reintegra, I think it is an attempt of the government to somehow compensate for this situation, which only will be resolved if we have a profound tax reform, which God knows when that may occur.

So it's a very important instrument because, although it's not mathematically perfect, but it's an attempt to kind of offset this cascade of taxes that we embed in our products before export, and that takes away the competitiveness of Brazilian exporters.

Now, the way this was brought back to the active stage, I mean, the way that they are bringing back the Reintegra does not give us any certainty about, if it will be available and in which volume. But it will depend on the budgets of the government every year. It will also depend according to the Minister of Finance declaration. It will depend on the exchange rates. So it's a mechanism which is there, but we do not know whether or not it will be used and which amount year-by-year.

So we fundamentally cannot use that in our planning. If it happens, let's say in 2015 Reintegra is 1%, fine. But at this stage, we cannot use that as, let's say, an assured cost saving or tax reduction in our planning.

Q - Eduardo S. Couto {BIO 15918458 <GO>}

But this year, you're not getting any benefit, right? If there's something next year, it would be incrementally positive, right?

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

No, yeah, no, nothing real. I think some residue from last year, I guess, but this is not. The answer is materially not.

Q - Eduardo S. Couto {BIO 15918458 <GO>}

Okay. Thank you, guys, and congrats.

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

Okay.

Operator

Thank you. Our next question is from Myles Walton of Deutsche Bank. You may begin.

Q - Myles A. Walton {BIO 6802513 <GO>}

Thanks. Good morning, guys. I was hoping to get a couple of questions in on the KC-390. And the first one is whether or not you'll get any kind of a cash advance of material size when that contract is signed. And the second part of that is whether or not to what extent the delivery - excuse me, the first flight of the KC-390 is an important cash milestone and/or profit recognition event for you.

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

Myles, to the first, for the cash, yes. There is always some down payment. I don't think it's anything, meaningful. I sincerely do not know. It's probably nothing which is meaningful. It's embedded in our planning anyway. And as far as economic recognition first flight, no. We incur - I mean, no, meaning there will be not a bump in revenues or economical impact. The first flight is, it's just a continuation of the development. We have been approving this development costs. Therefore, revenues, I think almost monthly, right, is that monthly? Yeah, monthly, so it's just an event, it will not trigger anything large.

Q - Myles A. Walton {BIO 6802513 <GO>}

Okay. (45:25)

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

It's an important event though because with that we can really initiate the flight test campaign. So, for the program it's a very important event. For the cash flow of the program, it's part of the planning.

Q - Myles A. Walton {BIO 6802513 <GO>}

The first flight, I guess I was more thinking of it maybe as a risk in the sense of you're quickly coming up on when you probably should be (45:55) the final assembly together, power on should be occurring probably in the next couple of months in prep for that final or for the first flight. So, I was more looking at it as a risk from any excess cost or delays. But it sounds like you're still looking at end of year?

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

Yeah, challenging, but the airplane is - the fuselage is totally assembled now. We're just trying to make the wings with the fuselage. And as you said, probably, yes, in the next couple of months. Do we have a rollout date for - yeah, we do have a rollout, Myles, scheduled for end of October.

Q - Myles A. Walton {BIO 6802513 <GO>}

Okay.

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

So, it's tight but doable.

Q - Myles A. Walton {BIO 6802513 <GO>}

Okay. The other one I had was you mentioned the lower development and research run rates versus your plan. And then just curious, is that because you're getting larger risk sharing than you anticipated, or is it because you're under-spending? Just any color on that. Thanks.

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

Yeah. We have - on the year, and that was planned, we had a higher concentration of contribution in the first half and the second half. Having said that, we are very unlikely that we're going to surpass, let's say, the \$300 million in developments. It's probably that we'll stay exactly south of \$300 million. Maybe a little bit less in research as well. And CapEx today, the best figure we have is sticking to the \$250 million. So overall, we're probably not going to reach the full \$650 million. We're going to stay a little bit below without of course jeopardizing the physical advancements of the programs. It's just a question of better execution than what we planned.

Q - Myles A. Walton {BIO 6802513 <GO>}

Okay. Good enough. Thanks, guys. Good quarter.

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

Thank you.

Operator

Thank you. Our next question is from Ron Epstein of Bank of America. You may begin.

Q - Ronald Jay Epstein {BIO 4430430 <GO>}

Yeah. Hey, good morning, guys. Just maybe a couple of quick follow-on questions because I think most - everything has been covered. But one thing we didn't talk about is that the sales campaigns. What should we think about for the second half of the year? I mean we're coming off of Farnborough which was - congratulations really good period for you guys. But what should we think about in the second half of the year?

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

Ron. Good morning, first of all. We have to make sure that what we have announced some are through and some are - still require some final documents and approvals or whatever. So, we have to make sure that we convert all that into firms. So, that's going to be - this has not been recognized in our backlog. So, our backlog does not reflect yet all those sales which - it's a priority for us in the second and in the next several weeks.

And we have campaigns literally all over the world. No fundamental change, spot opportunities in Europe, spot opportunity in Latin America. A little bit slower demand in Middle East but it is not so much meaningful. The 175 in service in United States is doing really well. I mean, the airplane has been extremely well accepted by the airlines flying it and so that makes us more optimistic for new orders, which may not happen this year, but next year we do expect some new orders in the United States. So, it's a mixed bag, and overall, as I said in previous question, I mean we are in a relatively comfortable situation as far as 2015 and the three years before the E2 is in service.

Q - Ronald Jay Epstein {BIO 4430430 <GO>}

Okay, great. And then maybe just one more (50:12) a more detailed question. A little while back, you guys announced that you're doing a JV with Zodiac for aircraft interiors. And then it's my understanding, a piece of the interior on the new E2s, you guys are doing wholly-owned subsidiary. Broadly speaking, what is the strategy with aircraft interiors now and do you have any thought of actually selling aircraft interior components outside of Embraer?

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

Good question, Ron. We do have a JV with Zodiac. The company's name is EZ. It's in Mexico. It's a 50/50 joint venture and they provide interiors for the E-Jets. So that's clearly one strategy. And we also acquired, couple of years ago, the control of a small company in California. It's called AST Interiors. They're more dedicated to seats. And we have been introducing those seats in some of our business jets. We are thinking about whether or not we could also use that company to make first-class seats for the E-Jets. So, if you ask so, we have those two, let's say, actions in - or tactics deployed.

Our vision today is much more that, we want you to have more and more vertical capability of seats and interiors at Embraer. We do not have the view to become an OEM of seats or OEM of interiors to provide to other companies. But we definitely are investing, having more verticalization of those components in our aircraft over time.

Q - Ronald Jay Epstein {BIO 4430430 <GO>}

Okay. Great. Thank you very much.

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

Thank you.

Operator

Thank you. Our next question is from Stephen Trent of Citi. You may begin.

Q - Stephen Trent {BIO 5581382 <GO>}

[Foreign Language] (52:20)

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

[Foreign Language] (52:23)

Q - Stephen Trent {BIO 5581382 <GO>}

[Foreign Language] (52:24) and thank you for the time ...

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

[Foreign Language] (52:30)

Q - Stephen Trent {BIO 5581382 <GO>}

Excellent, thank you for the time, gentlemen. Just one thing, looking at the movement that we have seen from the BRICS countries to create this big fund for the group, are you seeing any new potential opportunities there?

And then, related to that question, there's also been some recent controversial comments from some governing bodies regarding the conflict in Gaza - between Gaza and Israel. And have you seen any impact at all, in your business, or in your dealings with affiliates like Elbit Systems or anything like that? Or is it business as usual in the backdrop of these geopolitical waves?

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

Thank you, Steve. I suppose you want me to answer in English, right? Not in Portuguese. Okay.

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Q - Stephen Trent {BIO 5581382 <GO>}

I'm going to say English, for the benefit of the call.

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

Okay. Well, thank you, and there's a contribution to your quasi-perfect Portuguese. Well, no, no I mean, that this is BRICS bank, you maybe read about it in the press. No contact, no, I mean, it's - I think we know as much as you, probably less than you, about that. And we are certainly not counting on anything, if there is, in the future, funds available for either research or whatever, fine, but it's not in our radar yet, as far as anything to be included in our plans.

Gaza. Well, I did not complete the seminary, but I did go to - I have a little bit of knowledge about that region as far as biblical and pre-biblical times. It's a very, very complex issue. Unfortunately, it's 5,000 years of conflicts. I think business is above that. We are - to your question specifically, we have not seen any change whatsoever in our relationship with Israeli companies or airlines or Arab airlines which fly our aircraft. I think Brazil is very far from the region, and we're not a real part of that historical quests.

Q - Stephen Trent {BIO 5581382 <GO>}

Great. Very helpful, very helpful. And just a quick follow up to Joe Nadol's question earlier, any chance you might be able to give us, at least broadly, the gross margins per segment for the quarter?

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

Yes. Just a second. Yeah, so Commercial Aviation, around 22% and Executive Aviation as well, little bit higher than 22%, and Defense & Security about 20%. So, overall 21.9%.

Q - Stephen Trent {BIO 5581382 <GO>}

Okay. Very helpful. I'll leave it at that. Thanks very much, guys.

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

Thanks, Steve. (56:13).

Operator

Thank you. Our next question is from Ravi Jain of HSBC. You may begin.

Q - Ravi Jain {BIO 16135293 <GO>}

Hi, good morning. I just had a couple of quick follow-ups. One is on your Commercial Jet segment. What is your expectation on orders from Europe, let's say, in the next 6 months to 12 months? Given that of course growth has recovered, but still remains pretty sluggish there? And of course the E-Jet mix is different, I think it's more 190s and 195s, but do you see also a similar trend in margins like we saw the margins of E175s in the U.S. orders lately?

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And the second question was just a little bit more color, if you could give us, on the cost control initiatives and your outlook for the second half?

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

The first part of your first question, when you asked demand from where, I couldn't get - Europe.

Q - Ravi Jain {BIO 16135293 <GO>}

Yeah.

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

Well, spot opportunities. We have options. We have a very strong European base on the E-Jets. So, from time to time, we have opportunities of new orders or confirmation of options (57:25). So, it's good in the sense that it's not dead. It's there. It's happening, not in big quantities, but, from time to time, we sell E1s and E2s and E3s, so all over the continent. We have, as I said, a very strong European base.

Now, as far as mix, we are moving, probably seeking a significant way (57:51) from 190, 195s to 175s. So, this year, the overall balance of the year is ...

A - Operator

(58:02).

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

Yeah. So, this year, Ravi, we should see something like two-thirds of 175s, one third of 190s and 195 (58:11) which is up, with a significant shift from last past few years and that trend probably will stay.

As far as cost controls and we mean, we're with the same stance that we have adopted in the last several years. Filippo mentioned our efforts in SG&A, so it's call it a war, I guess, SG&A. And we are I think so far winning this war, not letting it (58:43) up, and all the efforts of course also manufacturing, productivity and quality. So nothing significant, but this is a absolute focus of top management of the company and it remains.

Q - Ravi Jain {BIO 16135293 <GO>}

Thank you. That's helpful.

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

Thank you.

Operator

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

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

Just to thank everyone for the attention, for the consideration, and talk to you in the next three months. Thank you. Have a nice day.

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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