

## Q3 2013 Earnings Call

### Company Participants

- Federico Curado, President and CEO
- Jose Filippo, Chief Financial Officer and IRO
- Unidentified Speaker, Unknown

### Other Participants

- Cai von Rumohr, Analyst
- Darryl Genovesi, Analyst
- Derek Sprorick, Analyst
- Eduardo Couto, Analyst
- George Ferguson, Analyst
- Steve Trent, Analyst
- Unidentified Participant, Analyst

### Presentation

#### Operator

Good afternoon, ladies and gentlemen, and welcome to the audio conference call that will review Embraer's Third Quarter 2013 results. Thank you for standing by. This conference call is being held during the Embraer Day in New York, with the presence of investors and market analysts.

At this time, the company will present its Third Quarter 2013 results. Afterwards, we will conduct a question and answer and instructions to participate will be given at that time. (Operator Instructions).

As a reminder, this conference is being recorded and webcast at [ir.Embraer.com.br](http://ir.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 subjects to risks, uncertainties. And assumptions, including, among other things, general economic, political. And business conditions in Brazil and other markets where the company is present. The words "believe," "may," "will," "estimates," "continues," "anticipates," "intends," "expects," and similar words are intended to identify forward-looking statements.

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

Participants on today's conference call are Mr. Federico Curado, President and CEO; Mr. Jose Filippo, Chief Financial Officer and IRO; Mr. Luciano Froes, Director of Investor Relations. I would now like to turn the conference over to Mr. Federico Curado. Please go ahead, sir.

## Federico Curado

Good afternoon, people present here today and also people who are in the web. Pleasure to have you here.

This was not our best quarter, for sure. As we have indicated in our last call, we did not expect a stellar quarter. But we did lose something in the range of \$150 million in revenues related to deliveries which will happen in the Fourth Quarter. And that, of course, deteriorated a little bit of our margins.

So, at this stage, we remain looking at, as we also indicated on our last call, at the lower end of our guidance. Certainly our challenge is -- has increased in the Fourth Quarter. But that's what we are aiming at.

So, I will be back at the end of the presentation. Filippo, you will conduct the presentation. And I will be back for Q&A. Thank you.

## Jose Filippo {BIO 1726218 <GO>}

Thank you. Thanks, Fred. And so we'll go to the presentation. And then we will turn back to further questions.

So, starting on page three, in the corporate highlights, we had starting with this important recognition being the fourth consecutive year in the Dow Jones Sustainability Index, confirming our commitment to sustainability and corporate governance standards of the company.

Following with an important highlight on the financial operation, in August and concluded in September, the company entering into an exchange of notes. We exchanged notes that mature in 2017 and 2020, to new notes that mature 2023. So we were able to have acceptance for about \$500 million. So that means that we have, in terms of our average terms of the debt an extension that we'll show in more detail later in this presentation. But this is important for the management of the profile of the debt of the Company.

FINAL

And in this page, also, we have a follow here by the important, for Embraer, that we received several recognitions from important institutions regarding people, finance. And social environmental recognition, by Great Place to Work, Capital Aberto, (inaudible). And also the Brazilian publication, Melhores da Dinheiro.

Okay, next page, page four highlights for commercial aviation, starting with delivery of 19 E-Jets in the Third Quarter. So, it's now 966 in total deliveries since starting this program. There was included in this 19 delivery number 1,000 E-Jet that was related to (inaudible) to Republic Airlines, which will be operated on behalf of American Eagle.

Also, regarding customers and clients, we had the announcement of KLM Cityhopper that added 6 E190 jets to the fleet. This is not a new order, because it was related to a lessor that was already included in our backlog.

But we have two new customers, new orders, related to Belavia Airways for two E195s. And also Aurigny Air Service for one E195.

Next page highlights for executive jets delivery of 25 executive jets in the Third Quarter, being broken by 21 light jets and 4 large jets. And an important milestone in this program, which is the first China-assembled Legacy 650 that made its first -- completed its first maiden flight.

Also, we used to highlight here some recognitions and the confirmation of our ongoing focus on operational excellence. We were again awarded -- this is for the second consecutive year -- AIN for honor aviation in quality and product support.

Some updates on the Legacy 500 and 450 program. We're still on track on the program. Now the three prototypes of the Legacy 500 program being completed 650 flight hours. And also in the Legacy 450, we're still on track for the first prototype preparation.

Another comment about this program is that Jackie Chan was announced recently as the launch customer for the Legacy 500 in China.

And concluding the highlights for executive jets, we launched recently the Lineage 1000E, which is the version of the Lineage for the E2 program.

Next page, page six, talking about the highlights of defense and security. Some -- regarding the modernization of the programs to Brazilian armed forces. We had two important milestones, which were the first delivery of the A-1 fighter jet for Brazilian Air Force. And the first flight of the AF-1 of Brazilian Navy.

Also in terms of investment in this segment, we recently announced the agreement to acquire the remaining portion of our partner, Atech. So we now come into direction of concluding this operation. And being the owner of 100% of the capital of this company. This is not yet reflected in the Third Quarter financials, because it was after the period.

Bloomberg Transcript

Regarding the LAS program, we're still on track, on schedule, the Jacksonville facility being prepared and delivery expected to -- is scheduled to happen by mid-2014.

In the satellite program, we selected suppliers for the satellite and the launcher. And the next step is the conclusion and execution of the contract signature.

And finalizing the defense and security, the weather company Orbisat had its named changed to Bradar Industria Societe Anonyme. And we get opportunity to announce, also, contracts in the amount of \$22 million for remote surveillance with Brazilian companies.

Okay, with that, we conclude the highlights. And then page seven, talking about the backlog, which was announced in mid-October. So, we had an increase from the previous figures to \$17.8 billion.

Basically, what we -- the result is the shift for the ILSC order, which was initially as a letter of intention for the E2 now became a firm order. It's a 50 firm order, plus 50 options.

Next page, page eight, in terms of aircraft delivery. From the left, we have the commercial jet delivery. So 19 aircraft in the Third Quarter, accumulated 58 in the year.

We had a couple of aircraft slip into the Fourth Quarter. And it's important that we've started to deliver some of the E175 of the North American recent orders.

In the right side chart, the executive deliveries. We had 25 aircraft deliveries in this Third Quarter, 21 light jets and 4 large jets, which accounts for the cumulative in the year of 66 deliveries, 52 light orders, deliveries. And 14 large deliveries.

So, with this picture, we're still confirming that we expect to reach our guidance. But towards the lower end, by the end of the year.

Next page, page nine, revenues by segment. So, we had in the Third Quarter, the total of \$1.3 billion in revenues. And accumulated of \$3.9 billion for the full year so far to September.

When we look by segment, of course, as a consequence of deliveries we had a reduction in the commercial and executive compared to the previous quarters. Defense was also affected by the dollar in this quarter, Third Quarter. And then we have, then, for commercial aviation this \$687 million in this Third Quarter, accumulated \$2.2 billion. In executive \$315 million in Third Quarter, with accumulated of \$860 million for the year. In defense, accumulated -- the quarter, \$267 million, with year-to-date numbers of \$828 million.

Next page, page 10, the revenues, I think, in total, showing the Brazilian figures, the real currency [ph] figures. So, we had the number that we just mentioned, the \$1.3 billion for

the quarter, \$3.9 billion accumulated in dollars, reflected into the reais figures of BRL2.9 billion in the quarter. And BRL8.3 billion in September to date.

Next page, page 11, we show the figures related to SG&A expenses and reflecting our continuous focus on expense control and reduction. We had this quarter, the Third Quarter, a reduction compared to the previous quarter, a total of \$163 million, compared to \$175 million in the Second Quarter, 7% less. Broken by \$112 million in sales expenses. And \$51 million in administrative and general expenses. So, the total of the year, we had \$499 million as the number accumulated to September.

On page 12, income of operations. So operating income, the result of \$76 million in the Third Quarter, accumulated \$251 million, with a margin of 5.9% in the quarter and 6.4% accumulated. Primarily, this reflects the number of aircraft deliveries. And the delivery and the mix, as we mentioned.

And just finalizing, recapping this here, the combination of the revenues that were missed with the fixed costs into a lower margin this year. And especially in the Third Quarter.

On page 13, talking about the EBITDA, this is just reflecting the previous information. So, we had \$156 million in EBITDA in the Third Quarter. And accumulated as of September of \$460 million, with an EBITDA margin of 12.1% in the quarter, accumulated 11.7% up to September.

The next page, net income, total of \$53 million in this Third Quarter, accumulated of \$78 million in the year, 4.1% margin. And what we see here is differently than we had in the previous quarters, we didn't have the effect of the dollar impact in the deferred income tax. So we were able to have a more normal situation in terms of income tax. So we return to this profit of \$53 million. The reais figures, BRL119 million, total accumulated of BRL170 million, which is important for the distribution of the results.

Next page, page 15, inventories. A total of \$2.8 billion in September. This reflects, of course, the missed deliveries. And the preparation of the Company for the Fourth Quarter, which has some more activity in terms of deliveries.

So, we come into a \$2.8 billion in the inventory. And not something that we couldn't expect. This is basically reflecting all the situations of the delivery concentration, especially the Fourth Quarter.

Next page, page 16, we have the free cash flow information. So, in the quarter, the lighter quarter is reflected in the operational cash generation. We could not compensate the investment level. So we had this total of \$102 million of operating cash generation. But investments of \$106 million in PPE. And \$80 million in intangible assets, returning to the net of negative \$84 million in this Third Quarter.

In terms of PPE, most of the investments are associated to the defense program. And also the Portugal plant in Evora. And also the (inaudible) project.

FINAL

In terms of the intangible assets, they're mostly related to the E2 investments. And also the Legacy 500 and 450. As you can recall, after we announced the official launch of the program of the E2, approved by the board, it becomes more deferred now. It's now expensed. It's now all the investments related to the E2 go to the intangible assets. And they are, then, deferred.

On page 17, in terms of investments, the year to date and outlook for 2013, a total of \$389 million as of September. It's good to recall here that we are highlighting the CapEx related to contract programs, mainly the defense and security programs, which are not included in the CapEx outlook figures that we release. So, we took the opportunity to highlight this for information in this chart. But so far, we have this -- the outlook of \$580 million for the year. And we have. So far, the \$389 million, as of September.

Page 18, in terms of our capital structure and related to investments and debt, we had -- the Company reported a net debt in this quarter of September, as a consequence of the quarter activities. But it's important about the financial debt that we have a better profile in terms of the average maturity of the debt, we extended almost one year of this debt, especially because after this, the liability management operation that I mentioned in the beginning of the presentation where we concluded in September and were able to extend about half a billion dollars from debt that won't be maturing in 2017 and '20 to the first half of 2023.

Also important that with this operation, also, we have a better profile in terms of short-term and long-term debt that we reduced our short-term portion of the debt from 6% to 4% in the end of the quarter.

Okay, with that, I finish the presentation of the financial numbers. And turn back to Fred to open the questions. Thank you.

## **Federico Curado**

So, I understand that the first questions come from -- will come from this audience. Is that right, Nadia [ph]? Okay. So, please, we are at your disposal. Mics over here. And one, two, three.

## **Questions And Answers**

### **Operator**

(Operator Instructions).

### **Q - Unidentified Participant**

I'm a little confused, still, about what impacted the gross margin this quarter. It was the worst in quite a while. I know you mentioned you had two deferrals. But was it all commercial? Was it across the segments? Was it price? Was it mix? Could you be very clear about what drove it down this quarter?

FINAL

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

It was -- the impact was all the business. We had -- we had part of our debt from commercial, where we have the margin of -- the operating margin of 7.8%. Then the executive business was negative, 3.4%.

**A - Federico Curado**

This is operating, not IFRS.

**A - Unidentified Speaker**

And the question is --

**A - Federico Curado**

Gross margin.

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

Let me conclude the operating, then I'll give you the gross margin. So defense was 8.6% margin.

So, in terms of gross margin, 19.1% in commercial, 16.2% in executive -- sorry, sorry. And 20.9% in defense. That -- the blended margin is 19.2%.

**A - Unidentified Speaker**

And I will just add on the commercial side, we lost a couple of airplanes. So, that certainly - I don't know how much that drove the impact. But certainly we have 1 point right there, maybe.

**Q - Unidentified Participant**

Which one of the three segments was down the most from, say, the First Quarter? You had pretty low volume in the First Quarter.

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

From the first, it was commercial.

**A - Federico Curado**

Commercial, from the first, yes, it's commercial. And the executive.

**A - Unidentified Speaker**

If I may add, also, just a little bit of color, if we look at the product mix, I think Third Quarter was, I would say, pretty unique when we think about the commercial aviation mix. We saw a pretty large number as it relates to the overall total of E-Jets delivered going into the North American market.

Bloomberg Transcript

For instance, just for a little bit of color, if we look at Fourth Quarter, we certainly expect a much more balanced weighing back into the 190, 195 platform. So, I think that's also an important element to consider in terms of the uniqueness, let's say, of this quarter in terms of the gross margin of that segment.

### **Q - Unidentified Participant**

I guess -- the implication I'm trying to figure out is that I know your 175 mix is going to go up next year, of course. So, we should think about year-over-year margins for 2014, maybe, being down, maybe like 8%, 8.5%, just on that powerful dynamic?

### **A - Federico Curado**

We are not ready to talk about actual guidance. But we'll certainly see a reduction in the margins of the commercial business. But we see it still remaining pretty healthy. It's probably the healthier, healthiest margin (inaudible) in our three businesses.

Of course, it will have, I don't know, maybe a 2 or 3 point, percentage points, impact, 2.5 or something, next year. And that, of course, we will make guidance in February. But it is planned to be, even with a lower mix, I mean, a mix of a lower-size aircraft, it should be on the -- helping the average of the Company. So, that's a healthy business, even going forward, even with a loaded US market, deliveries for US market.

### **Q - Unidentified Participant**

Thank you.

### **A - Federico Curado**

Yes, Miles [ph]. And then we'll have Joe [ph] here.

### **Q - Unidentified Participant**

So, Fred, just to follow up on that one, if you look to the implied margins for the Fourth Quarter, what you're kind of pointing toward is a pretty substantial growth year on year on virtually no revenue growth. Is that just you're trying to energize the workforce to pull off whatever they can, or is there really some confidence that you can actually pull off an implied 13.5%, 14% EBIT margin in the Fourth Quarter.

### **A - Federico Curado**

I think so. I think that's fair. It's a very fair question.

If you do the math, you're going to arrive at something close to 13% to 14% to get the average (inaudible) on the revenues. I think what will depend is, fundamentally, deliveries of larger cabin aircraft and executive jets. The airline business looks pretty consistent with the guidance, although at the lower end. But it looks pretty consistent. Defense, as well. And we have a very large challenge in making sure that we deliver.



FINAL

I mean, the airplanes are -- there's no industrial challenge. It's more -- I mean, of course, there are industrial challenges. But not one that would make me concerned. It's really down to commercial risk, some customers without financing, some customers which are almost closing. And things like this.

So, I think the plan calls for the lower end of the guidance. Is there a risk? Yes. There is a downside risk there. But I don't think it's a substantial amount.

So, at this stage, we have to stick to our plan, which is to deliver those numbers. It will be a challenge for sure. We have done, I think, pretty close to that last year and in previous years. So, over \$2 billion in the quarter. And strong recovery of margins. So, it's not that far from something we have already done in the past.

### **Q - Unidentified Participant**

I guess one other clean-up question. The other expense turned into other income this quarter. And I know in the press release you talk about it on a year-on-year basis. And that's fine. But what happened sequentially that improved the other income line, or other expense that you can talk to.

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

Oh, the comparison was that we had some canceling of some -- we had the return from the canceling penalty.

### **Q - Unidentified Participant**

So, sequentially, that's the differential?

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

Yes.

### **Q - Unidentified Participant**

Okay.

### **A - Federico Curado**

Here, please.

### **Q - Unidentified Participant**

Fred, just on the executive jet business, with the negative margin in the quarter, what's really driving it? Is it all pricing? Because we know you have an aggressive competitor north of the border here. Is that the whole problem, or that plus just the market in general? Or are there manufacturing issues? If you can just walk us through sort of the issues. And then what your plan is to bring that back into profitability?

### **A - Federico Curado**

FINAL

Thank you, Joe. We -- there is a pricing pressure. I mean, recently, as everyone knows, Cessna took an important decision not to engage into a market share fight. So once, of course, the Hawker jets are no longer into the market. So, this mid to lower end side of the market is really, now, fundamentally down to Cessna and Embraer.

So, I think both are trying to hold pricing. But I think the biggest competitor is not Cessna or we are to them, it's the inventory of used aircraft, which, although it not growing. But the asking price is coming down.

So, that associated with a small increase or maybe no increase whatsoever. For the leaders of the market, it's still kind of flat or shrinking. It really creates a not very healthy environment for pricing.

Having said that, Joe, we also have challenges on the cost sides. And, obviously, with a strong investment program, an even more important challenge on the cash flow side in that business.

Next year, as we certify the Legacy 500 we should get some alleviation on the investment side. And I certainly speak -- and I think Ernie [ph] and Mark [ph] will talk about this in more details, we certainly expect a strong turnaround, if you will, as far as performance in this business.

So, even in an environment where the market is not still booming. And it's not coming back earlier, I'm afraid, we intend to have a strong recovery as far as our margins and our cash associated with that business, as well.

### **Q - Unidentified Participant**

And on the commercial side, you cited that there were a few aircraft that slipped into Q4 from Q3. And then last quarter, I think, you noted that we're going to come in towards the lower end of the guidance for the year.

Could you characterize -- I'm sure it's a host of different things. But is this predominantly finance -- customer financing that's an issue, or is it manufacturing, or is it just simply demand?

### **A - Federico Curado**

It's -- again, we are talking about certainly less than a handful of airplanes. And it's more of a commercial risk, rather than -- it's not industrial, for sure. It's really the ability of a customer to take delivery or not. That's fundamentally it. But it's not necessarily lack of financing, it's really more on the commercial side, fleet size, that sort of --

### **Q - Unidentified Participant**

And free cash flow guidance for the year, finally. You had said, it's, I think, in the higher double digits. But at this point you're going to say it's due -- basically whether we can get

Bloomberg Transcript

the deliveries out the door or not is going to determine whether you can achieve the guidance. Is that fair?

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

Yes, that's correct.

**A - Federico Curado**

I don't think we ever said higher double digits, have we? Double digits starts with 10, right? Did we? Did we say higher? Okay. Bigger challenge.

**Q - Derek Sprorick**

Derek Sprorick at RBC Markets. With the JetBlue deferrals of the 190s, in particular the 7 in 2015, do you think you'll be able to backfill that with your current backlog, or bring forward some of those deferrals from your existing orders?

**A - Federico Curado**

I will say that we expect to refill those lots with other orders, not to accelerate anything. You talk about 24 airplanes, which they do not impact our '13 or '14, for that sort, deliveries of Skyline. So, 2016 and '17, that's what we'll find customers to fill those lots.

So, we -- I mean, we don't feel that uncomfortable. It was not a big surprise to us. We don't feel that uncomfortable to deal with that situation.

**Q - Unidentified Participant**

Okay, here we go. With the S&G expense reductions, is that re-occurring. And do you see any other opportunity to take costs out of the business. And, if so, can you quantify that a little bit?

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

I think that this is an ongoing program. We expect to see more benefits from this. Of course, this is harder to do -- this is not a dilution of the costs within the business. So, we're working a lot in terms of building a shared services platform and doing something common to the business to support the business, all the cleaning up, the back office activity being more effective in the way we do.

So, we still expect to see, of course, reductions going forward. And, if not, the reduction (inaudible), at least as we can expect some growth in terms of revenues that this can be like the dilution, also, in the cost. But the nominal costs should be reduced going forward.

This is not -- we're not giving guidance, necessarily for that. But that's the trend.

**Q - Unidentified Participant**

Okay, thanks.

## A - Federico Curado

Okay. So, before we get to Cai [ph] and Ron [ph], Noah [ph] is up, please.

## Q - Unidentified Participant

(inaudible) on that last question, with regard to the effort to backfill existing backlog, can you just update us on how exciting or not exciting current campaigning activity is? Maybe by geography or type of customer on the commercial side?

## A - Federico Curado

Maybe (inaudible) and Paulo [ph] I think, can elaborate a little bit better. But, certainly, we see the largest demand for the next few years coming from the United States regional airlines, replacements of older RJ 50 seaters. And -- but there are opportunities for larger aircraft popping up here and there. Latin America, potentially, China. But I think Paulo can give you a little bit of better color to that.

So, again, maybe advancing a little bit, 2014 looks very comfortable, at this stage. And also we have a very good sentiment about 2015 at this stage, as well. I'll say a better sentiment about 2015 at this stage than what we had about 2014 a year ago.

So, I think later on Paulo may give you some better color.

## Q - Unidentified Participant

Okay. And just one follow-up. On the mix issue within commercial going more towards 175 from 190, 195, are there any numbers or quantification at all that you can put around how different that margin is from one aircraft to the other, or how much pricing pressure there is in the orders you've won over the last 12 months versus prior?

## A - Federico Curado

I don't know if you have anything? I think order of magnitude, Paulo has been running the business in double digits operating margins. So, probably we'll see a small decrease next year. Still in the high single digit arena, more or less. That's what we would expect.

Of course, we're going to fine-tune that and give you a better precision when we issue guidance. But it's like from, maybe, lower double digits to high single digits, probably in that approximation.

## Q - Unidentified Participant

That's helpful. Thank you.

## Q - George Ferguson {BIO 5297518 <GO>}

George Ferguson with Bloomberg Industries. Switching gears and going to defense, can you talk to us about the KC-390. And how you position that airplane between C-130s, A-

400M. And the C-17. So what you see as the opportunity for that airplane. And how you position it in there? How does it stay competitive in there?

## A - Federico Curado

Okay. It's -- the KC-390 is actually a multi-mission airplane. It's not only a cargo aircraft. But also it has a tanker capability. It also has some Medevac capability. Operates in unpaved runways. And will operate in Antarctica.

But let's say, size-wise, it's a very, very direct competitor to the C-130J. It's a 21, 23 ton aircraft, actually a little bit bigger than the C-130J.

We sit between -- if you think about Airbus, we sit between the C-295 and the A-400M, right in between. So, we don't compete with either.

We are quite larger than the C-295. And we're way smaller than the A-400M. And we are much, much smaller than the C-17.

So, it's really a -- it's a C-130 market. A different concept, of course. A faster airplane. It's a twin jet, not a turboprop. And, obviously, with the benefit of a clean ship design.

The way we market this, we think about marketing this airplane, just to talk about milestones which are important, we shall fly before the end of next year. And we intend to be in the market with an ability to deliver airplanes in 2016 on.

So, initially, of course, we have Brazil as a potential main customer. But we also have a few other countries we have investment participation in the program. And with which we do have LOIs, also, for their tests. So, hopefully, next year we will be able to execute the contract with the Brazilian Air Force for the serialization of the KC-390. And from that we'll be able to negotiate with other customers.

We see at least a 700-aircraft market, let's call it open market. So, there is a much larger number of C-130s there. And the total market's much larger than that. But we understand that, of course, with Lockheed marching and FMS. And the whole US, let's say, influence in defense equipments, there are some markets which are very, very unlikely that we'll be able to penetrate.

So, we see at least 700 airplanes in which we have a fair chance to compete for. And that's market share, whichever market share we can take there, 20%, 30%, that's definitely a good result for us. And just to finalize, we do have an agreement with Boeing defense to market our KC-390 in a few of those markets in which we don't see a possibility for us to sell direct. So, that may increase, let's say, the customer base of the KC-390.

Yes, Cai?

FINAL

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

Yes, Fred, in recent meetings you've talked of the above-average potential for profitability of the Legacy 500. And then the 450. With the delays you've had on the program, with the costs you've seen, with the difficult pricing you've had in the market, could you give us some color on how you see the profit potential of that program next year and in '15?

## **A - Federico Curado**

Qualitatively, yes. We are about 12 to 16 months late in the program, as you know. So it should be in the market after the end of the next half -- middle of next year. And it has been, probably, the most -- the smoothest development that we have had, or, even better, the smoothest certification and entry into production aircraft that we have designed.

So, we do expect a relatively smooth ramp-up next year. We're probably looking at maybe 6 or so 500 deliveries. And ramping up, of course, in 2015, which is the year where the 450 shall also enter into production.

So, '14, next year, maybe 6 of the 500s, '15 ramp-up and 450 coming up. '16 we will see a more fully -- fully benefit of having both in the market.

This is an add-on revenue for us, Cai, because we're not that segment at all. So, those two airplanes do not take any share, at all, from our Phenom 300 or our Legacy 650. So, that's going to be, really a step function in terms of revenue for us, again, becoming more meaningful towards 2015.

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

And pricing?

## **A - Federico Curado**

Pricing, as I said, we -- I think it's a very good question. There is a -- I think there is a question of market share versus pricing. We have not definitely -- that's not the way we do business, in a price war. So, we have been trying to price our aircraft at a level, at competitive levels. But levels that bring reasonable potential for margins.

So, at this stage, we see that segment with -- and, I think, Mark, we also talk about it's a segment which will grow in everybody's forecast, a little, personally, a little bit better than other segments. So, we should be able to have, I don't know, 50, 60 airplanes a year.

But that's something which, of course, we have to fine-tune as we go. And we think we're going to have sound and healthy price and margins. We do see a learning curve, relatively fast, with those two aircraft. So, we still have about eight months to go, or something, in certification. How many hours we have logged in the flight test campaign?

Bloomberg Transcript

## A - Unidentified Speaker

(inaudible).

## A - Federico Curado

So, over 720 hours in the flight test campaign. So, we are on good track for certification. And the airplane has very good flying qualities. And I think as far as passenger appeal and customer appeal, it's -- we really believe it's going to be in the best in class. And both will winners, as the Phenom 300 is already.

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

You mentioned that next year you would get relief from development on the Legacy 500 starting down. With the build in the E2, does the total development level of spending continue up, or do we get any relief?

## A - Federico Curado

Probably we will have -- the Legacy 500 will come down. The 450 is still there. We -- and the E2, the 175, as I recall, we will just have a little bit next year. Most is going to happen this year. So, I think the E2 will be the real demander of capital next year. We don't have those numbers yet. But I'll say likely it's going to up, total investment. Likely.

## Q - Unidentified Participant

A quick question for --

## A - Federico Curado

Wait to the front. Ron was, for some time, waiting here.

## Q - Unidentified Participant

Just a quick question on working capital management. So, maybe that's for Jose. For a long time, working capital management at Embraer has been not great, right? Free cash flow has been bumpy.

Are you doing any initiatives now to focus on working capital management and to try to improve it?

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

Yes, I think that this is important that you mention it. Of course, the increase in inventories that we see in the end of last quarter was followed by an increase in suppliers, as well. It's the same effect in terms of pressure of working capital. So, it is something, also, here.

I think that I mentioned -- that Fred mentioned about, also, in terms of the executive aviation, we're still working on better capacity to project that, to avoid pressure from working capital is something, also, that we think we can have some benefits going forward in terms of working capital.

This is under still -- we have, still, a demand from working capital because of the type of the business. But we are working on trying to reduce this impact. And we are identifying those points and trying to improve the way we manage that.

Yes, that is correct.

### **Q - Unidentified Participant**

And do you have a good sense from your seat, when you look around Embraer, that you kind of where the cash is, or where cash is being used? I mean, is the enterprise reporting system fine-tuned enough that you really do have a good idea of where you need to get the cash out of?

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

Yes, definitely yes. (inaudible) control is.

### **Q - Unidentified Participant**

Okay.

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

I think it's more like gearing up of (inaudible) along the business of what impact that's -- every effect of each action does in terms of cash. It's a balance of, like, the economical impact and the financial impact, just on double duty, very strongly, along the organization.

### **A - Federico Curado**

If I may add, Ron, I mean, we have been in the business jets business for, let's say, 12 years. But more intensely for, maybe, 10 years. And in this period we have made a significant commitment of capital, which was generated mostly by the airline business. But more recently, in the last, maybe, five years, also by the defense business, in not only product development.

So, we went from nothing to two Phenoms, the two Legacys, which are still under final certification, significant (inaudible) Legacy 650. And the Lineage. But also a significant investment in the customer support infrastructure. And, typically, that's a kind of a need-to-have to be in the business. And the return on capital in those investments they are a little bit far in the future.

So, as a -- in a nutshell, that has been the big demand for investment. As we now enter into the E2 investments, a lot of that -- the funds will come from the actual generation -- cash generation from its own -- from the airline business itself. So, a lot will come from there.

But we do expect -- we must and we do expect that the business jets side of the house will start making a much more relevant contribution for that cash. And defense is a pretty kind of self-sustained and contributor of cash, as well.



We don't see, at least, now we do have a 15-year plan, we don't see in this horizon, knowing what we know now, any need for raising capital, new capital. We are managing our debt, I think, very -- in a very competent way, extending term. And keeping cost or even reducing cost a little bit.

So, absolutely, cash is actually probably our number one point of attention, even more than margins.

### **Q - Unidentified Participant**

Thank you.

### **Q - Steve Trent** {BIO 5581382 <GO>}

Thanks. Good afternoon, Freddie. And gents. Thanks for the time. Steve Trent from Citi. Just two questions from me, if I may.

First, you mentioned in 3Q the other income, the liquidated damages. Was there any particular geographic bias to where that came from, or was it fairly small?

And then the second question. I wasn't sure. But there seemed to be a little bit of action from some employees on your production floor, a smallish work stoppage of some sort. And I was wondering if you could give us a little color on what happened?

### **A - Federico Curado**

Sure, thank you.

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

Yes, the (inaudible) was \$16 million. It was just an isolated thing, one customer. It was not something like systematic.

### **Q - Steve Trent** {BIO 5581382 <GO>}

Not any particular region, one customer, right?

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

Yes.

### **A - Federico Curado**

Steve, on the labor side, what we have -- well, we have not had a strike for as far as I can remember. And we're not having any strikes. So, what we have is a very diligent union, which had the practice of blocking roads, literally blocking roads. And forcing employees off the buses. So, they -- so what they did, they had to get off the bus and walk. So they get late to work two hours. It's a very embarrassing thing.

So, there's nobody stopped. Everybody's working.

And this issue, it's in Brazil, the way this thing goes, the two unions -- there is a union for the companies, also, the Federation of Companies. So, they are negotiating on our behalf with the unions. And this thing's still going on.

So, what we have done to our employees that we have readjusted all the wages back to September for the inflation of last year. So, I mean, they are -- they feel protected. They feel fine.

It's much more, let's say, as I said, an activist attitude from the union than really an internal concern. It's certainly a disturbance. But not something which is -- the workforce is pretty much with the Company.

**Q - Steve Trent** {BIO 5581382 <GO>}

Okay, very helpful. Thank you.

**Operator**

(Operator Instructions).

**Q - Unidentified Participant**

So, thank you, It's (inaudible) with HSBC.

My question is regarding, again, Fourth Quarter. I just wanted to understand. This is probably the First Quarter where you're going to see the FX kicking in, more or less. So, it started -- the depreciation of the real started in May. So, it's probably going to begin in October or November. How does that play out in terms of margins, especially for EBIT margins, first?

And second, we're talking about the low range of the guidance, maybe delivering 32 aircraft in the Fourth Quarter. Is this feasible, first. And what's going to be the breakdown, more or less, between 175s and 190s?

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

Let me address the FX question. Yes, of course, this -- what happens is that we have to take the FX when it comes. If you experience the variation, it has to go through the inventories before, then we're going to benefit in the margins, if that's the question.

What we saw is the second -- in the Second Quarter we had the more -- the devaluation was a little bit more, then reduced in the Third Quarter, actually. So, we may see some of this impact. Most of them, already, in the costs are there. But some we still may see going forward in terms of the last quarter.

But then, I think, it's not a major impact in the margins.

## A - Federico Curado

To the share of deliveries in the last quarter, it's probably, maybe, even more 190s, I don't know, 60% 195s. And 40% 175s.

## Q - Unidentified Participant

Okay, thank you.

## A - Federico Curado

And, yes, it's doable.

## Q - George Ferguson {BIO 5297518 <GO>}

George Ferguson, again, from Bloomberg Research. So, I'm not sure if you know this today. Boeing announced that they're going to increase 737 production to 47 a month, starting in 2017, which ends up being pretty darn close to entry for E2. I'm wondering if you could talk to us about managing the risk that customers that couldn't get an airplane within five or six years would move, would gauge down a bit to an E2. And now Boeing's opening up slots for those people, potentially. And, perhaps, making the 190, 195 E2 a bit harder for you to sell?

## A - Federico Curado

On one perspective, on one side, there is no direct competition between the 190. They are really smaller aircraft, 50% in size smaller. So, that's pretty much a very sizable difference. So, whatever is done directly as a result of Boeing and Airbus moves does not have a direct impact in competition for us.

Having said that, there is, yes, if you consider the overall commercial airline business, there is that capacity, the number of passengers to be flown. So, of course, the more -- the higher the production rates of narrow body aircraft, that puts the pressure on the whole industry. So, in the sense that capacity is taking out, the passenger. But also financing capacity.

So, the way we feel, of course, is that we are safely enough away from really competing with 737, which the majority of them will be -8 and -9s. So, airplanes which start at 160 seats and go up to almost 200 seats. Same with Airbus 320, 321.

So, I think the business plan of the E2 was based on, I think, very solid, even maybe conservative, assumptions. Let's keep in mind we have 60, almost 70, customers around the world. We will have, I don't know, maybe 1,600, 1,800 airplanes in service when the E2 comes.

So, there is a very natural, let's say, customer base and follow-on opportunity for the E2. And, by the way, the airplanes will be extremely, extremely competitive.

FINAL

So, they will be able to have a 100-seater or a 125-seater in the 195, the 190, 195, with cost per seats very similar to larger aircraft. So, that makes a very compelling case for us. So, cost per trip way lower, cost per seat's very, very close. So, that's one of the assets that the E2 family will have.

So, I don't think there's a-- we don't see a direct impact. I did not know about this production rate increase. I just -- it's a bit surprising that there are that many, because that, probably, is going to trigger a response in Toulouse. So, a lot of passengers have to be out there to fly all these aircraft.

But we are -- as I said, we are in a different segment, much, much smaller. But I think, also, in a strong position in that segment, which is sub-120 seats.

By the way, guys, finishing this, I think you can still go for dessert before they take everything out. So, as soon as we're done here, I encourage you to get some dessert.

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

Hi, Fred. It's Eduardo, Morgan Stanley.

My questions are getting back on the defense business. There was a deceleration on the revenue growth in the Third Quarter. Is it because of the BRL depreciation, or what impacted the defense business on Third Quarter?

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

Yes, it was --

**A - Federico Curado**

Foreign --

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

Yes, primarily the exchange rate, exactly.

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

And looking forward, should we see a slowdown in the growth, given that the currency continues around 2.20 or so?

**A - Federico Curado**

No, we'll see a double-digit growth for next year, probably, in the defense, in dollars. Keep in mind that we still have, 50/50 exports and Brazil.

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

50% in dollars and 50% --

Bloomberg Transcript

## A - Federico Curado

Yes, because the exports are dollar-denominated. And 50% reais, which, of course, helps the Company to hedge, to have a natural hedge, also.

Sorry, there was a gentlemen there. And then Ron, then I think we're done.

## Q - Darryl Genovesi {BIO 20862546 <GO>}

Hi, Darryl Genovesi with UBS. So, I'm just wondering. I think in the beginning of the year you had said SG&A as a percentage of sales was going to come down, I think it was 12.3% last year to 10% or 11% this year. I know the SG&A line's come down on an absolute basis. But it looks like it's kind of just come down in line with sales.

So, just wondering if -- you don't look like you're going to get there this year. But does that imply that there's further for that to come down in 2014?

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

Yes, again, we're not giving any, at this point, guidance for next year. But if you see this year we had the SG&A in the Second Quarter about 11% of sales. And now it's 12%, a little bit more than 12%. But more because of the reduction of the revenues rather than its nominal cost.

So, I think we should expect this trend of reducing this to levels less than, probably we have.

## A - Federico Curado

We should not see a material increase in the Fourth Quarter. And we will see a very significant increase in revenues. So, the dilution will be, I think, important for the year. End of the year, I think you'll see a better figure than what we have so far, year to date.

## Q - Darryl Genovesi {BIO 20862546 <GO>}

Okay. And then just a cleanup question. Can you just give us what the combined services revenues were for the quarter?

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

So, it was approximately \$220 million, primarily half commercial and the rest between the other two businesses.

## Q - Darryl Genovesi {BIO 20862546 <GO>}

Thank you.

## A - Federico Curado

Ron, I think you have the last question.

FINAL

Bloomberg Transcript

## Q - Unidentified Participant

Okay, thanks. One thing we haven't talked about much is M&A. And, in particular, Hawker Beechcraft seeks to be back out on the market. Is there anything you can mention about that, or not?

## A - Federico Curado

No. We're not interested in Beechcraft. We're not looking into that at all. I don't know if no -- I have no idea who let that gossip. That's a gossip. We're not even looking into the numbers.

So, not an attractive proposition for us.

## Q - Unidentified Participant

Thank you.

## Operator

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

## A - Federico Curado

Just to thank everyone for attending. As I said, there's dessert served outside the room. There's a 10 minute break. So we'll be back in 10 minutes so we don't -- we're not late. Thank you.

## Operator

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

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