

## Q1 2006 Earnings Call

### Company Participants

- Anna Cecilia Bettencourt, Head of IR
- Antonio Luiz Manso, CFO
- Marcello Rodriguez, Controller.
- Mauricio Botelho, CEO

### Other Participants

- Brian Strell, Analyst
- Daniela Bretthauer, Analyst
- Darren Shannon, Analyst
- Heidi Wood, Analyst
- Joe Nadol, Analyst
- Laurie Ranton, Analyst
- Ray Neidl, Analyst
- Ron Epstein, Analyst
- Sandra Arnold, Analyst

### Presentation

#### Operator

Good morning, ladies and gentlemen and welcome to the audio conference call that will review Embraer's First Quarter 2006 results. At this time all participants are in a listen-only mode. Later we will conduct a question-and-answer session. (Operator Instructions)

As a reminder this conference is being recorded and webcasted at [www.embraer.com](http://www.embraer.com). This conference call includes forward-looking statements or statements about events or circumstances which have not occurred.

Embraer has based these forward-looking statements largely on its current expectations and projections about future events and financial trends affecting the business and its future financial performance. These forward-looking statements are subject to risks, uncertainties and assumptions including, among other things, general, economic, political and business conditions in Brazil and in other markets where the Company is present. The words believes, may, will, estimates, continues, anticipates intends, expects and similar words are intended to identify forward-looking statements. Embraer undertakes no obligations to update publicly or revise any forward-looking statements because of new information, future events or other factors.

In light of these risks and uncertainties the forward-looking events and circumstances discussed on this conference call might not occur. The Company's actual results could differ substantially from those anticipated in the forward-looking statements.

Participants on today's conference call are Mr. Mauricio Botelho, Chief Executive Officer; Mr. Antonio Luiz Manso, Chief Financial Officer; Mrs. Anna Cecilia Bettencourt, Head of Investor Relations. And Marcello Rodriguez, Controller.

I would now like to turn the conference over to Mrs. Anna Cecilia Bettencourt. Please go ahead Ma'am.

## **Anna Cecilia Bettencourt**

Good morning, everyone. Thank you for joining our conference call to discuss our First Quarter 2006 results in U.S. GAAP that were released on Friday, May 12th simultaneously with the financial statements in Brazilian GAAP.

Joining us today are Mauricio Botelho our CEO, Antonio Luiz Manso our CFO, Marcello Rodriguez our Controller. We are webcasting this conference call with a slide presentation on our website at [www.embraer.com](http://www.embraer.com). I advise you all to follow it.

Now, Mr. Botelho will present the quarter's highlights. Thank you.

## **Mauricio Botelho** {BIO 13386065 <GO>}

Good morning. Good morning everyone. Thank you, very much for your attention. First of all I must suggest, just tell you that I am contacted at this conference call. I'm in Europe so if anything wrong comes with the connection I will get through again. But maybe it happens that I'll be out.

But, coming to our results that we are disclosing today, I want to say that we had in this quarter two very significant issues, very important issues. The first one is the very widely disclosed corporate shareholder restructure that we implemented and approved, on March 31st. This operation, I qualify it as the most important issue that happened in the Company's life since its privatization. It comprised of substituting all shares of preferred and common shares by only common shares and assuring Embraer's approval of capital corporation.

This for sure will have impact in our future, our future lives because it will create the basis for a sustainable growth and continuous continuity in our business for years to come. I think that the access to capital markets and increasing financing resource will be assured, which will allow us to develop further our product line and expand our presence in the world and in new programs.

The second point, which was easily a big impact in our results when we compare it to First Quarter 2005, has to do with the Real appreciation. There is a chart which shows how the

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Real appreciation developed from the First Quarter 2005 to First Quarter 2006, representing a 17.7% year-to-year. This had a strong impact in terms of our gross margin and in terms of our EBIT margin. If the Real would stay at a low level or a high level it would not matter so much. But the quarters that when it was in a decreasing -- when the Real is growing in a growing curve this means the Dollar devaluated, then we have a problem. We acquire goods at a higher interest rate -- exchange rate and we recognize the revenue at a lower one.

This has a direct and straight impact on the gross margin. As a consequence operational margins, EBIT margins and the net margins will be also affected and this is what we have seen so far. If we consider just the last quarter 2005, we had an appreciation of just 2.4. As a consequence we kept our gross margins, same margins at the same levels. And representing another situation that we will give you which is the interest in service of the new aircraft family. But we go through this later on.

Secondarily, we are living at -- with additional costs that are sustained by the Company in view of the interest in service of this new family, representing additional costs. But this will be over soon.

The dispatch reliability of the fleet has been significantly improving and as we anticipated, by mid-year, the majority of the problems that were found in the systems and our own problems and the training from operators, will be solved. I think that the levels that we are reaching today with the operation is coming together to a very acceptable points and soon everything will be over.

If we just compare what happened with us in this respect, with some situation that we lived when we had the ERJ 145 Jet approved into the market, we had in 1997 for instance, the gross margin was 26.9%. In '98 it grew two points and in '99 it reached 32% on gross margins. The problems that we were living at that time, they were much more concerning than the problems that we are living today.

I have full confidence that what -- the improvement in the operations will come from the action we have been taking with our customers in terms of training of the crews. And in taking -- with our suppliers and between ourselves in terms of improving the quality and solving gaps that existed in the different systems.

I would like to say also, that however we see this decrease in margins we saw a very strong financial health. Our cash, net cash which leveled 3, \$302m, the indebtedness is in a very comfortably managed position, 72% on a long-term basis. Total accounts receivables at a reasonable value of 480 million while commercial aircraft representing 136m.

We are at this point preparing to grow our delivery rates, to increase them, for the second half of the year, as well as preparing ourselves to start deliveries, to have certified and start deliveries of the EMBRAER 195. This at the same time that represents a very good perspective for the near future, it also represents an impact in inventories which are consistently growing to allow us to launch this increase in performance.

We have achieved also significant diversification. In this quarter 62% of the revenues came from the Commercial Airlines business. 11% is up to Jets. 10% the Missiles and 17% Service.

What I say is that furthermore, is that in conjunction with all those facts we have achieved significant new contracts. China Eastern Airlines, we won, acquired five 50-seat aircraft which is going to be supplied by the Harbin Embraer factory.

Embraer and U.S. Airways Group reached an agreement involving the previous contract converting 57 ordered EMBRAER 170s into 25 firm EMBRAER 190 and 32 additional firm EMBRAER 190 aircraft which are subject to reconfirmation by U.S. Airways. There are options over and above those figures.

AeroRepublica of Bogota, Columbia placed a firm order of five EMBRAER 190s with options for an additional 20 aircraft.

Royal Jordanian Airlines acquired seven firm EMBRAER 195s with deliveries that -- which are due to start Fourth Quarter 2006.

These new contracts has led us, the others that were already achieved by the company are allowing us to maintain a solid, firm order backlog all with \$10 billion representing about 350 aircraft to be delivered.

Additionally, we can say that the Executive Jets business area is doing very well and the Phenom 100 and 300 have been very well accepted by the market. We are recently, just as a lateral note, we presented to the market a new program, the Lineage 1000, which is, by our surprise, been receiving a better acceptance than what we would imagine for the first week of -- presented it -- when we presented it at Geneva show, EBACE.

Now, with all those facts I pass to Anna Cecilia to proceed with the results and performance directly to this presentation. Please Anna.

### **Anna Cecilia Bettencourt**

Thank you, Mauricio. So we delivered 27 aircraft in the First Quarter of 2006 compared to 30 delivered in the same period last year. As approximately 60% of aircraft delivered, forecasted for 2006 I expect it to be concentrated in the second half of the year.

Due to the slightly lower number of aircraft delivered the net revenue for the Airline segment reached \$504 million in the First Quarter 2006 compared to \$578 million in the same period of last year.

Despite the increase in net revenues the decrease in gross margin in the First Quarter 2006 compared to First Quarter 2005 is related to the E-Jets learning curves as Mauricio mentioned. And the 17.7% average appreciation of the Real against the U.S. Dollar during the period, which Mauricio already explained in the beginning of this presentation.

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Due to the lower number of aircraft delivered, net revenue for the Airline segment reached (audio gap) compared to the \$504 million in the First Quarter of 2006, compared to \$578.2 million in the same period in 2005.

Comparing the two, First Quarter 2005 net revenue for the Jet segment in the First Quarter 2006 remained stable at \$78.5m, representing 9.7% of the Company's net revenue.

Deliveries to the executive jet market doubled in the First Quarter of 2006 resulting in a higher revenue totaling \$86.1 million in the First Quarter of 2006 compared to \$33.1 million in the same period in 2005.

Revenues of customer service and other segments increased 90.6%, mostly due to the revenue reformation of \$32.3 million from OGMA, a maintenance, repair and overhaul facility acquired in March, 2005 and to the delivery of two used ERJ 145 aircraft to the Brazilian Air Force.

Hence exactly half of our operating expenses are denominated in Reais. The 17.7% average appreciation of the Real against the U.S. Dollar, period-over-period, had a negative impact on income from operations.

Operating expenses also increased because of this Company's effort to support the commitment of the EMBRAER 190 model operations and of the implementation of a dedicated sales force and a marketing strategy to promote the Phenom 100 and the Phenom 300, which will begin to recognize revenue starting -- middle of 2008 with the first deliveries of the Phenom 100.

Additionally, the development of the Phenom 100 and Phenom 300 contributed to the increase of \$8.7 million in research and development in the period.

Due to the lower operating results, net income in the First Quarter of 2006 decreased by \$31.2 million over the same period in 2005 reaching \$65.3m, equivalent to \$0.37 of earnings per diluted ADS.

Higher average cash, cash equivalent and temporary cash investments available during the quarter contributed to an increase in net interest income which reached \$32 million in the First Quarter of 2006 compared to a net expense of \$7.1 million in the same period in 2005.

During First Quarter 2006 trade accounts receivable slightly increased by \$31.3 million to \$482.1m. Of this total amount approximately \$135.5 million is related to aircraft deliveries for which sales financing arrangements are under restructuring processes.

From the First Quarter 2005 accounts receivable decreased by 44%, a strong indicator of commitment to reduce participation in temporary sales finances restructures, as we notice with continuing recovery with the airline industry.

During the First Quarter 2006 inventories increased by \$174.9 million reaching \$1,686b. This increase is due to the EMBRAER 170/190 products in ramp up for the second half of the year and the beginning of the serious production of the first EMBRAER 195 which is expected to be certified by mid-2006.

As a result we reached a net cash position of \$302 million in the First Quarter of 2006. At the end of First Quarter 2006 we had cash equivalents and temporary cash investments were \$1.7b. On the same date short and long-term loans excluding non-recalled debt and recalled debt were \$1.4b.

Of the total debt, 72% is long-term and 13% is effectively denominated in Reais and indexed to the CDI at weighted average interest rates of 11.8% per annum. The remaining \$1.2 billion is denominated in other currencies, primarily U.S. dollars which are weighted average interest rate of 6.9% per annum.

The long-term credit lines are due to mature between 2006 and 2008, and have an average lifetime of two years and four months.

At the end of the quarter we reported a firm order backlog of 341 jets including 26 aircraft from the ERJ 145 family and 315 aircraft from the EMBRAER 170/190 family.

At the end of the quarter also our firm backlog was \$10.4 billion mainly related to the remaining (inaudible) at the same level of \$10b.

We maintained our forecast for deliveries of 145 aircraft in 2006 and 150 aircraft in 2007.

Now Operator, we may open this conference call for the Q&A session. Thank you.

## Questions And Answers

### Operator

Ladies and gentlemen we will now begin the question-and-answer session. (Operator Instructions) Our first question comes from Ray Neidl from Calyon Securities.

**Q - Ray Neidl** {BIO 14015874 <GO>}

Good morning, everyone.

**A - Mauricio Botelho** {BIO 13386065 <GO>}

Good morning, how are you doing?

**Q - Ray Neidl** {BIO 14015874 <GO>}

Just a couple of general things here. With the R&D trends, going forward, it seems like the bulk of -- the new products that you're doing it seems like most of the R&D

developmental costs should be out of the way, is that a correct assumption to make?

**A - Mauricio Botelho** {BIO 13386065 <GO>}

Sorry, I missed the last sentence there, I missed it.

**Q - Ray Neidl** {BIO 14015874 <GO>}

The research and development, going forward, now that you have a lot of your product lines pretty well ready to go to market, will we see a decrease in R&D expenses going forward?

**A - Mauricio Botelho** {BIO 13386065 <GO>}

Yes, it is correct at this present situation this is what we see. However, when we look at the companies such as ours which is heavily based on technology and new developments, improvements and products this is not a situation that we would expect to be maintained as it is.

We are studying and analyzing new programs. I have mentioned several times that in the Executive business, executive jet market, we intend to launch two new aircraft between the Phenom 300 and the Legacy 600. We are going to, in the near future there will become a real program. And the other actions will be taken.

**Q - Ray Neidl** {BIO 14015874 <GO>}

Okay. Now going forward with the business jets, you mentioned is the learning curve that's penalized your earnings during this quarter. Going forward, how many quarters should we expect to see that count to be incurred on that particular product?

**A - Mauricio Botelho** {BIO 13386065 <GO>}

Due to the sophistication of the products. If we're talking about very sophisticated aircraft such as the EMBRAER 170/190 which is brand new in terms of technology, for us, actually if you compare the systems that are there with the systems that have been operated in other aircraft, rather than A380, the existing aircrafts have a lower level of technology than ours embedded in this aircraft.

So if the level of -- let me see, impact in terms of putting the aircraft into full service in a continuous basis would depend on the sort of technology that you are using, if they are new or not. Of course this represents also for a learning situation that becomes an asset to the company. Which means that every new program you take the benefit of the lessons that you learned in the past. And the trend is that you, more and more, you are more efficient in delivering and putting the product in full force in the market.

**Q - Ray Neidl** {BIO 14015874 <GO>}

Okay great. And finally, with the EMBRAER 170s and 190s and that family of aircraft becoming more important a product line for the Company, your revenues are going to go up because its more expensive aircraft and I'm assuming also that you should be getting

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higher margins off of these aircraft as they're being sold worldwide. Is that a correct assumption and when would we see those margins starting to really affect the Company?

**A - Mauricio Botelho** {BIO 13386065 <GO>}

It is -- we expect the margins to grow but it also depends on the competing environment. The prices are defined not by the suppliers. But by that entity called market and the competition is always there. And if we are not competing at this time and let us say, when we talk to product-to-product. But there are other situations which may transform an aircraft which is not a competitive aircraft if you look at it individually with our EMBRAER 190, for instance. Based on the connected values that are brought, they become competitor, I mean A380 for instance, as a product it is a product which weighs 13 tons more than ours.

This rate represents a burden in terms of acquisition price and operational cost. However, if the A380 comes with financing that is backed by export credit agencies in differentiated ways, if it is put together with other aircraft of the family taking benefit of commonality. For instance, the typical example is the deal with Iberia which was a dispute on our 110-seat aircraft EMBRAER 195, however -- and all of a sudden it was comprising 115-seats, there was 120, 150 and 180. And then what is price at that point? You don't know what it does mean.

So the margin issue is something that of course it will prove because we will gain productivity. But it is also something that is dependent on the competition now. We expect to have it growing.

**Q - Ray Neidl** {BIO 14015874 <GO>}

Great, thank you very much.

**A - Mauricio Botelho** {BIO 13386065 <GO>}

You're welcome sir.

**Operator**

And our next question comes from Daniela Bretthauer of Santander Investments.

**A - Mauricio Botelho** {BIO 13386065 <GO>}

Hello Daniela?

**Q - Daniela Bretthauer** {BIO 13380169 <GO>}

Hello. Good morning. A quick question on -- you mentioned the FX impact on your gross margin and operating profit. In the past I have seen a table where you actually breakdown the average FX that you purchase and the reports in the impacting sense. Do you have that information, that's for Anna, for gross margin and operating results rather than just the margins that you show here in the charts?



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### A - Anna Cecilia Bettencourt

Let me check, the table that you used to see is related to the Brazilian GAAP, where you see the average exchange rate for the import and the average exchange rate for the export. While in U.S. GAAP the impact is -- applies only to the portion that is currently denominated in Reais and not all cost of goods sold which is normally about 10% of the total cost -- about 10% of the total cost is denominated in Reais.

### Q - Daniela Bretthauer {BIO 13380169 <GO>}

But can I use that same spread for the U.S. GAAP then?

### A - Anna Cecilia Bettencourt

No, you cannot because in U.S. GAAP the equipment, the material that we import which are denominated in U.S. Dollars, they are accounted in U.S. Dollars .so there is no translation. Also the sales that we make, the costs that we make in U.S. Dollars, they are accounted in U.S. Dollars. So you should apply only to the circumstance of our costs, which are Brazilian denominated Reais.

### Q - Daniela Bretthauer {BIO 13380169 <GO>}

Okay, because I was just trying to sense, if in U.S. GAAP there was something else rather than just the FX impact and I guess by your answer it is -- there is no other effect right?

### A - Anna Cecilia Bettencourt

No. And it's a look comparing -- I mean, First Quarter this year to last quarter of 2005 you will see from a slight improvement of 50 basis points, okay? Because the currency wasn't -- devaluated -- did not, that much, okay, just 2.4%. So we're starting to see some improvement in our gross margin.

### Q - Daniela Bretthauer {BIO 13380169 <GO>}

Okay. And finally, just to -- on -- Mauricio Botelho mentioned that there will be an impact of the certification of the 195 in inventories and I guess in --.

### A - Mauricio Botelho {BIO 13386065 <GO>}

No, no, no, sorry. It was not the certification Daniela

### Q - Daniela Bretthauer {BIO 13380169 <GO>}

No. But that there will be an impact because you are building up, right, the -- well, you're testing that aircraft?

### A - Mauricio Botelho {BIO 13386065 <GO>}

No, the inventory is because we will be -- we are started to manufacture the aircraft to be delivered in the second half.

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**Q - Daniela Bretthauer** {BIO 13380169 <GO>}

Right.

**A - Mauricio Botelho** {BIO 13386065 <GO>}

So we are growing our inventories to face the near delivery, that's it.

**Q - Daniela Bretthauer** {BIO 13380169 <GO>}

Can you quantify this impact, just so that we know how much your inventories can drop?

**A - Mauricio Botelho** {BIO 13386065 <GO>}

I can't --.

**A - Anna Cecilia Bettencourt**

(inaudible) Daniela.

**Q - Daniela Bretthauer** {BIO 13380169 <GO>}

Okay. Thank.

**A - Antonio Luiz Manso** {BIO 1845027 <GO>}

Daniela?

**Q - Daniela Bretthauer** {BIO 13380169 <GO>}

Hello Antonio.

**A - Antonio Luiz Manso** {BIO 1845027 <GO>}

Yes, basically we have \$1.6 billion in inventory and the trend for the year end it's to \$1.5, \$1.45b. As Mauricio mentioned it's differentiated by the initial of production and deliveries of ERJ 195. And also the ramp up of the 170/190 family.

So if we don't increase our production we won't be able to delivery the 145 aircraft in the year.

**Q - Daniela Bretthauer** {BIO 13380169 <GO>}

Okay, thanks. And sorry, it was a little noisy here because the (inaudible) was just announcing the names of the players for the World Cup. So I couldn't really hear. But sorry about that.

**A - Mauricio Botelho** {BIO 13386065 <GO>}

Okay, no problem.

## Operator

Our next question comes from Joe Nadol of JP Morgan.

**A - Mauricio Botelho** {BIO 13386065 <GO>}

Hello Joe, how are you doing?

**Q - Joe Nadol** {BIO 3056499 <GO>}

Hello Mauricio. My first question is for you Mauricio. Could you just update us on the market for the 190 and 170 recently. And how you think the bankruptcies in the U.S. are progressing? Maybe touch on the rest of the world as well?

**A - Mauricio Botelho** {BIO 13386065 <GO>}

I will. I keep saying that we see opportunities going on with -- for this family of aircraft. Activity keeps being very hot. And I see different areas in the world, different customers. But the main point is what is happening in the United States, that is due to the relevance, the weighted relevance of this market.

Why we distribute our products around the world, we have spread the customer base. But the fact is that an order outside of the United States is of 10 aircraft, 15 aircraft at most. In the United States we talk about tens of aircraft, hundreds. And this is what is the impact.

What we see is that environment is developing, I think, very -- in a very reasonable way. We see movements from Northwest and positive movements, agreements with pilots with the restructuring of their operation. And I think that they are growing. And all the evaluation that we have is that they are growing -- they are progressing with their plans and very likely that they may go out of the Chapter 11 situation early next year maximum. So this is good news because then they are in the process of considering a new fleet of aircraft.

At the same time we see other customers who also operating and operating very well the products 170 and looking at this program with large satisfaction which is good because future expansions.

This is what I can tell you Joe. I believe that things may become hotter in medium-time.

**Q - Joe Nadol** {BIO 3056499 <GO>}

Okay. My second question for you Mauricio is on the narrow body replacement programs that are -- that both Boeing and Airbus are studying. You've mentioned a couple of times and I think publicly, very recently, that you think you could be a partner with either one of them. Can you give us any more color on the degree to which you've had conversations with them, if any. And what the timings of these programs, you think might be?

**A - Mauricio Botelho** {BIO 13386065 <GO>}

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No, I don't have a timing for it, neither I do have a program for it. What I have been commenting, in different occasions is that I see -- look at both companies and I see the challenges that they are facing, both of them. Huge programs on their hands. Some with parallel programs which demands resources in an extraordinary way and this is valid for both companies. And what we see -- and then we look at us and we have to recognize that we have capabilities that could be very useful and very relevant in situations such as this one that I perceive.

What I have mentioned is that -- and this is how I feel it, is that if I were them I would be looking at us. But this doesn't mean that actually there is anything going on or any program already existing.

**Q - Joe Nadol** {BIO 3056499 <GO>}

Okay. I have two more questions on operating expenses, very specific questions. The first is you note that on the 190 there's been additional selling expenses and I imagine it's just getting the aircraft, all the teething problems fixed.

Can you comment on A, what the incremental amount of selling expense due to those problems were in the quarter and then secondly, are you directly compensating JetBlue and/or Air Canada for their -- the hit they're taking to their P&L?

**A - Mauricio Botelho** {BIO 13386065 <GO>}

Well I don't have the figure that you ask for. No, I don't have. But Anna, do you have?

**A - Anna Cecilia Bettencourt**

Yes, we do have. We are talking about in terms of new sales for structure and for the business jet we are talking about something about 6, \$7 million (attrition). And product and support we are talking about 60 and (\$70m).

**A - Antonio Luiz Manso** {BIO 1845027 <GO>}

The influence of the Real against the Dollar in this month -- in this quarter is very -- it's stronger.

**A - Mauricio Botelho** {BIO 13386065 <GO>}

But also it is important to realize that the second portion of your question, about compensation. This is not actually the approach. What we have seen is that the aircraft presented some difficulties. But not only that. Represented also that there were problems in training the different crews -- the problems, internal problems from the customers as well as is.

So what is at place is a joint-effort from the customer's side, from our side to solve the issues as fast as possible. And this is what's happening. Nobody has talked already, has shown up something like compensation or any notifications, nothing like that.

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**Q - Joe Nadol** {BIO 3056499 <GO>}

So do we think this runs off starting in Q2? I mean, JetBlue has been saying that the aircraft is doing a lot better.

**A - Mauricio Botelho** {BIO 13386065 <GO>}

Well in some -- in the presentation provided by one of the top executives something like two, three weeks ago they just mentioned that their aircraft presented a better dispatch reliability than the Airbus AP20. So, it's moving on.

**Q - Joe Nadol** {BIO 3056499 <GO>}

Okay. The final question is on the -- it looks like there was a \$10 or \$12 million charge for OGMA for this some kind of legal provision. Is that a one-timer, is it a one-time charge and could you just give a little bit of comment on that?

**A - Mauricio Botelho** {BIO 13386065 <GO>}

Anna, this is for you.

**A - Anna Cecilia Bettencourt**

Marcello will answer this question.

**A - Marcello Rodriguez**

Yes, this is expense. It's related to -- it was considered in the price when we purchased OGMA. But it's related to accounts receivable that if we receive we will -- we would have to pay for the work that is OGMA. So this is realization of that process.

**Q - Joe Nadol** {BIO 3056499 <GO>}

It's non-recurring?

**A - Marcello Rodriguez**

No, it's not recurring.

**Q - Joe Nadol** {BIO 3056499 <GO>}

Okay, thank you.

**A - Mauricio Botelho** {BIO 13386065 <GO>}

Thank you, Joe.

**Operator**

And the next question comes from Heidi Wood from Morgan Stanley.

**A - Mauricio Botelho** {BIO 13386065 <GO>}

Hello Heidi?

**Q - Heidi Wood** {BIO 3095506 <GO>}

Hello Mauricio how are you? A couple of questions. I want to follow-up on some ones that were asked before. I just want to understand this R&D expense this quarter, a little bit better. Going from last year to this year that \$20 million delta, it looks like about 5 of it is foreign exchange and about, you said, I think 8.7 was the Phenom 100 and 300. So there is an order of \$6 million increase on E-Jet and I guess I thought that expense was going to be tailing down. Can you talk a little bit about why that number was a bit higher?

**A - Mauricio Botelho** {BIO 13386065 <GO>}

Anna, please?

**A - Marcello Rodriguez**

Yes, I can tell you. This expense is related to a retrofit of previous years that we sold. So as you know that previous years normally have a much higher cost than the regular one. So when we sell that we take the excess of cost and put directly on the R&D expense.

**Q - Heidi Wood** {BIO 3095506 <GO>}

Okay. And so would you describe this period as sort of peak R&D expense for you? Will it be heading down after this?

**A - Marcello Rodriguez**

Because when you finalize the -- of working with the previous years, as the previous years you take out the excess of cost from the inventory and we recognize directly on the R&D which is an expense in U.S. GAAP and it's (for assets) in Brazilian GAAP.

**Q - Heidi Wood** {BIO 3095506 <GO>}

Okay. And then on the gross margin front. And again I'm recalling remotely as well, can you provide for me a better breakdown from that year-over-year decline to the 28.7%. How much of that was foreign currency and how much of that was learning curve?

**A - Anna Cecilia Bettencourt**

Well normally we do not open. But what we can tell is that 10% of our cost, about 10% of our cost is Brazilian Real denominated. So if you apply 17.7% evaluation so bad debt represents an increase -- a decrease in our gross margin. And the relation is that remember that First Quarter last year we delivered approximately 18 ERJ 135s, which is much more major products. In this last quarter we delivered only six or four ERJ 45s. So declining from 16 in the First Quarter of 2005 to four. Of this -- although we are seeing already some learning curve improvement with the EMBRAER 170. But the additional -- the EMBRAER 190 with deliveries started at the end of last year, we could not increase that much our margin.

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## Q - Heidi Wood {BIO 3095506 <GO>}

Well yes exactly. That's why it's a little bit tough to break it down on the outside, is that mix of FX product mix and then learning curve. So maybe let me ask it another way. When you look at the progress you're making on the E170/190 family, how are you doing relative to the plan?

## A - Anna Cecilia Bettencourt

We are doing as we planned. With the EMBRAER 170, production lead time for the EMBRAER 170 improved. In the (Brazil) it is launched today. Also you must take into considerate that we expanded our customer bases so adding new customers so we have a less concentrated delivered. But if you look back to the -- to specific customers, if you look back to the EMBRAER 190 most of the deliveries that were Easyjet, Air Canada at the beginning. So we are not benefiting from expanding the customer base and also the learning curve associated with the 190 product.

## Q - Heidi Wood {BIO 3095506 <GO>}

Okay. Great. And the last question and I'll let someone else jump in. But can you talk to us a little bit about -- you're doing very nicely on this business jet area already. Can you give us a sense as to the profile of the business jet buyers that you're seeing? Are they mostly U.S. domestic? Are these corporations? Are these individuals? Where are you gaining the most traction with your current product line?

## A - Mauricio Botelho {BIO 13386065 <GO>}

It depends on the products that we are looking at. The Legacy, we are talking about corporations, about charter companies, shared-ownership companies. That is where basically, the interest is, very few individuals. If you go to the Phenom 100 and Phenom 300 you have also different source -- different type of customers. But then you find in the Phenom you will find more individuals in that respect.

So it will depend on the program. The fact is that I think we are achieving what we intended, which we are starting to improve. I know enough that we are just starting. I know that -- but what I mean is that we are achieving what we intended. We are achieving different sort of customers because we are addressing them with different products.

The Lineage itself, we introduced it in the EBACE Air Show. Let me just commented that normally we don't do that because it really doesn't mean anything of significance because it's not the commitment it does not bind anybody. So it should not be taken into account as something of value. But just as general information, at that show we had 10 Lineage sold under quotes, sold under quotes sold, because there is no commitment. We expect to transform them into commitments soon. But this shows that the products are good. The products are calling attention from the market. And we are very happy with that.

## Q - Heidi Wood {BIO 3095506 <GO>}

Okay. Great. Thanks very much guys.

**A - Mauricio Botelho** {BIO 13386065 <GO>}

Thank you.

## Operator

The next question you have comes from Sandra Arnold from ATW Magazine.

**A - Mauricio Botelho** {BIO 13386065 <GO>}

Hello Sandra.

**Q - Sandra Arnold** {BIO 1870487 <GO>}

Good morning, it might be afternoon where you are. I wanted to ask you, the 195, that's going to go to fly be this -- is it going to be this summer or how does it look for being on time for that delivery schedule? Are you still expecting it to turn out the way you like?

**A - Mauricio Botelho** {BIO 13386065 <GO>}

It is on schedule, it is on schedule. We intend to have it certified by June and the first delivery, if I'm not wrong, is August. But we are on schedule.

**Q - Sandra Arnold** {BIO 1870487 <GO>}

So you expect the first delivery to be in August?

**A - Mauricio Botelho** {BIO 13386065 <GO>}

To be -- as planned, I am here -- really I don't have here in my hand. But it is on schedule. Nothing new from what has been forecast before.

**Q - Sandra Arnold** {BIO 1870487 <GO>}

Okay. The other thing I was going to ask you about the sales of the 135/145, are you getting any new orders, are you just filling the backorders that you have? What's the status of that 135/145 production?

**A - Mauricio Botelho** {BIO 13386065 <GO>}

Very few new orders, today. Very few new orders. But Stewart (Peters).

**Q - Sandra Arnold** {BIO 1870487 <GO>}

You're still getting some. And has the availability of used aircraft affected that, do you think, the --?

**A - Mauricio Botelho** {BIO 13386065 <GO>}

Of course, of course. Today -- as that has called -- the large regional airlines which have intensively acquired 50-seater aircraft. They want to progress further because the (scope)

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laws are relaxing and so on. If they want to grow with a 70-seater or above that level, they will try to find users for their 50-seater. So in fact there is an offer of used 50-seaters.

For our side, very few. Antonio may say how many. But there is very few.

**Q - Sandra Arnold** {BIO 1870487 <GO>}

And are some of these people, do you anticipate that they might want to convert their orders to the larger aircraft is that a trend that continues?

**A - Mauricio Botelho** {BIO 13386065 <GO>}

Sorry Sandra, I missed the beginning.

**Q - Sandra Arnold** {BIO 1870487 <GO>}

Oh I'm sorry, the trend towards the larger RJs or the 170/190 type of aircraft, do you anticipate that any of these orders that are on backlog do you anticipate some of these people may switch, convert their orders to the larger aircraft?

**A - Mauricio Botelho** {BIO 13386065 <GO>}

Well some. You see that not converts order. But -- you had a lot, for instance, had converted some orders into 175. They have options, are always offered in a sense that they can -- when exercising the option they can change the aircraft from one type to another type. So it may happen.

**Q - Sandra Arnold** {BIO 1870487 <GO>}

All right, well thank you. Those were my questions.

**A - Mauricio Botelho** {BIO 13386065 <GO>}

It was good to talk to you. Thank you.

**Operator**

Our next question comes from Ron Epstein from Merrill Lynch.

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

Yes. Good morning.

**A - Mauricio Botelho** {BIO 13386065 <GO>}

Hello Ron, how are you doing?

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

Good, how are you Mauricio?

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**A - Mauricio Botelho** {BIO 13386065 <GO>}

They're driving me hard.

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

Very good. The first question is for Anna. You include the offset from suppliers that you have in R&D. What is the R&D plan for the year?

**A - Anna Cecilia Bettencourt**

Just a moment please. We are talking about \$200 million R&D, gross. But again, almost 90 -- between 80 and 90% of the total R&D is local currency denominated. So we are talking about (inaudible) here. So it is being affected by the currency fluctuation.

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

Now of that 200 gross how much offset will there be from supplier payments? For example, when the 195 gets certified don't you get something back from the suppliers to offset against that 200?

**A - Anna Cecilia Bettencourt**

Yes, there are some offsetting. We are talking about, in terms of offsetting, of around \$40m.

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

So just back to Heidi's point and the first question. So Q1 is really front loaded in terms of R&D. If you're using \$160 million net run rate, then Q1 is front loaded, correct?

**A - Anna Cecilia Bettencourt**

Yes, I mean it depends, I mean we will be recognizing some contributions from the (inaudible) orders in the second half of the year.

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

Okay. Then another question for you Anna, I think at the end of the last quarterly call you mentioned that you thought -- that -- or, not you, that the Company thought that gross margins would be in the 30% range, maybe, for the year. Is that no longer the case? So that when we're thinking about gross margins for this year where should we think about modeling them?

**A - Anna Cecilia Bettencourt**

We still we are keeping 30% gross margins. But if we still see some stronger fluctuation in the currency we will be around 29% or something like that.

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

As the currency continues to strengthen. But if we assume from here to the end of the year currency was say stabilized flat --.

### **A - Anna Cecilia Bettencourt**

Yes, we estimate just 30% average for the year.

### **A - Marcello Rodriguez**

Ron, we wait for I think the end of the year inventory level of 30%.

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

Okay. And then, all right. So we go back to the E-Jets now. What is the cycle time on the 170, the 190 and how far behind are you in production? Because I remember at the beginning of the year you guys were a couple of weeks behind. So, that's really three questions?

### **A - Mauricio Botelho** {BIO 13386065 <GO>}

We are taking it to the planning position. We are reversing the situation.

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

Oh. So what is the cycle time now on the 170 and the 190?

### **A - Mauricio Botelho** {BIO 13386065 <GO>}

It is in about 4.6 months.

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

For both airplanes?

### **A - Mauricio Botelho** {BIO 13386065 <GO>}

Yes, the 190 is somewhat bigger than that, I can tell you, about five months.

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

Okay. And then Mauricio a question for you. So when do you guys tell the world all the biz jets that you've sold? So far there's the one announcement the 50PM-100s. So when do we learn about the rest of the jets that have been sold?

### **A - Mauricio Botelho** {BIO 13386065 <GO>}

We'll have to -- we'll be announcing the number of backlog and deliveries and so on, by mid-July, during the (FABROY) show, we will have a press -- an investor meeting over there, investor and analyst meeting over there. And we intend to announce it at that point.

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

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Okay, that's great, thank you.

**A - Mauricio Botelho** {BIO 13386065 <GO>}

Thank you, Ron.

**Operator**

The next question we have comes from (Brian Strell) from (Inca) Investments.

**A - Mauricio Botelho** {BIO 13386065 <GO>}

Hello.

**Q - Brian Strell**

Hello good morning.

**A - Mauricio Botelho** {BIO 13386065 <GO>}

Good morning.

**Q - Brian Strell**

I have a question about the income tax rate and relating to how the GAAP income tax expense, how that relates to the Brazilian GAAP. I notice that it's in Brazilian GAAP you have an 83 million expense and \$8 million in the U.S.? Could you just explain some of the differences in there?

**A - Anna Cecilia Bettencourt**

Yes, well first the differences are defined that this last quarter due to the capital restructuring we did not distribute interest on shareholders' equity, which is in fact deductible. So it's a tax benefit for our Brazilian company.

And regarding the difference between Brazilian GAAP tax rate and U.S. GAAP tax rate, Marcello will address these differences.

**A - Marcello Rodriguez**

The income tax, the effective income tax rate in Brazilian GAAP is influenced negatively for the payer, of course, based on the exchange variation of investments brought. So we had to add up the expense that we had in the Brazilian GAAP to the income tax. So the opposite effect would happen in the U.S. GAAP based on our investments abroad, especially in Europe where you have the exchange variation between real and -- excuse me, dollars and usage. So we had to exclude the effect so we had the nominal rate, 34%. But the effective rate was reduced on the Second Quarter.

**Q - Brian Strell**

Okay. The next question I have is regarding the Phenom program and I understand that you are expensing some of the sales expenses currently. Are any of the expenses being capitalized for that program?

### **A - Marcello Rodriguez**

No, no, none of those expense is capitalized, nor in Brazilian GAAP or U.S. GAAP. They go directly in the P&L.

### **Q - Brian Strell**

Okay. And are those Phenoms are they -- can they be built on the 145 lines, production lines or --?

### **A - Mauricio Botelho** {BIO 13386065 <GO>}

No, they are not going to be there. It is -- first of all, it is important to see that it is a different sort of aircraft. Different specifications. So it is likely to be -- to have structural -- manufacturing one of our plants in the hinterland of Sao Paolo and assembly line in another plant out of San (Rosa).

### **Q - Brian Strell**

Okay, okay thank you, those are my questions.

### **A - Mauricio Botelho** {BIO 13386065 <GO>}

Thank you.

### **Operator**

The next question comes from (Laurie Ranton) of Aviation Daily.

### **Q - Laurie Ranton**

Hello everyone, I was just wondering if you could clarify a comment that you made earlier in terms of preparing to grow delivery rates in the second half of the year. Can you tell me how many planes you are delivering a month now. And how much you expect that to grow?

### **A - Mauricio Botelho** {BIO 13386065 <GO>}

We have a guidance of 145 aircraft for this year. We are retaining ourselves to this guidance. We have delivered 37 First Quarter. Normally, every -- the first half of the year comprises about 40% of the annual deliveries and this is because we have a significant number of holidays in this first part of the year. So normally it comes 40% first half and second half 60%. So we are attaining to the 145. So we -- this means that we will grow our rate of deliveries from the second half -- sorry, Second Quarter and further on, on the third and Fourth Quarter.

Just a matter of arithmetic, I didn't make the accounting here. But the way that 145, 40% second half, we have the first half we had delivered 27 so you know how many in the Second Quarter. And then 60% in the second half of the year.

**Q - Laurie Ranton**

All right, thank you.

**A - Mauricio Botelho** {BIO 13386065 <GO>}

Thank you.

**Operator**

(Operator Instructions) And we have a question from Darren Shannon from Flight Global.

**Q - Darren Shannon**

Hello, how are you all doing?

**A - Mauricio Botelho** {BIO 13386065 <GO>}

Hello Shannon, how are you doing?

**Q - Darren Shannon**

I'm fine thank you. Can you give us some more details about this next generation of business jets you mentioned there, the one between the Phenom 300 and the Legacy?

**A - Mauricio Botelho** {BIO 13386065 <GO>}

No, unfortunately no. The program has not launched so it's still in studies.

**Q - Darren Shannon**

So do you reckon there will be something by the end of the year?

**A - Mauricio Botelho** {BIO 13386065 <GO>}

Probably not. Mostly likely next year.

**Q - Darren Shannon**

All right then. Can you give us an update then on your production schedule for the Phenom? You were talking about expanding or even doubling it to open up some slots?

**A - Mauricio Botelho** {BIO 13386065 <GO>}

Yes, that's our intent. We are now -- if we -- we had planned for a significant number of aircraft per month. If we would attain to that program we would be accepting orders just

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for 2010 and that will allow us to satisfy the market demand, we will expand our production line. But the totals on that I will not disclose until the plan is totally finalized.

## Q - Darren Shannon

Okay, well thank you very much for your time.

## A - Mauricio Botelho {BIO 13386065 <GO>}

Thank you.

## Operator

That does conclude today's question-and-answer session. I would like Mr. Botelho to proceed with his closing statements. Please go ahead sir.

## A - Mauricio Botelho {BIO 13386065 <GO>}

Very well thank you. Ladies and gentlemen. thank you very much for your attention. Appreciate having you to talking to us and we are ready to clarify any further doubt you may have. Please contact us directly and what I can say is that we are firm on track on what we are planning for the year and we will be into showing better figures on quarters to come.

Thank you. Pass the word to Antonio Luiz and to my colleagues in Brazil.

## A - Antonio Luiz Manso {BIO 1845027 <GO>}

Okay, thank you very much. And we, Anna, Marcello and me waiting for your questions (for reacting) where is necessary.

## A - Anna Cecilia Bettencourt

And we hope to see you in July this year, in our analyst meeting and the investors. There is an air show which will be July 19th in London.

## A - Marcello Rodriguez

Thank you, very much all, we will be here to answer any questions. Good bye.

## Operator

And we do thank you everyone. That does conclude Embraer's audio conference for today. Thank you, very much for your participation and thank you for using Conference Call (inaudible).

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