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Brazilian jet maker expects to outlast crisis Embraer relies on backlog of commercial orders, though future is uncertain Aviation

By Patrick Blum

LISBON-- Amid the global economic and financial crisis, demand for aircraft of all types and sizes has gone into a tailspin as airlines, fighting for survival, cancel orders or push them back to an uncertain future date. But Embraer, the Brazilian plane maker, is in good shape to weather the downturn in the small commercial aircraft and executive jet market, says the company's president and chief executive, Frederico Fleury Curado.



Mr. Curado, appointed in April 2007, when strong demand for regional and executive jets was driving a rapid expansion of the company's production capacity, has since overseen a painful adjustment to the downturn.

"We took the firm action needed to protect ourselves from the threat to our company's long-term strategy," Mr. Curado said during a telephone interview. "We've re-dimensioned the company, resources and investments, reduced expenses across the board and laid off about 20 percent of the work force."

Embraer, a leading maker of commercial aircraft of up to 120 seats and executive jets, has sharply reduced revenue expectations: "We had projected revenues of seven-plus billion dollars for 2009, we now project \$5.5 billion," he said.

Revenue last year was buoyant at \$6.3 billion, up 20.8 percent from 2007, but there was a sharp drop in the fourth quarter as the crisis began to tell. In the first quarter this year, Embraer posted a net loss of \$23.4 million, down from a profit of \$85 million a year earlier, on sales down 13.6 percent to \$1.15 billion.

"For commercial aircraft, we have not had any cancellations. We've had some deferrals to 2010 and 2011," Mr. Curado said. "For business jets, we've had both deferrals and cancellations."

Hardest hit has been the company's Legacy family of business jets, derived from the ERJ 145 regional airliner, which has suffered a 30 percent drop in orders. Last month, Hainan Airlines halved an order for 50 of the planes and stretched its delivery schedule for the remaining 25. But, Mr. Curado said, the effect of cancellations had been lessened by strong demand for newer products like the Phenom line of light executive jets.

"On the Phenom program, we have a very large backlog of over 800 aircraft, so even with some cancellations, we don't anticipate any impact on the Phenom assembly line," Mr. Curado said. "Phenom benefits from being a new product, so there is a large backlog."

Over all, the order backlog, a key measure of negotiated sales, fell to \$19.7 billion in the first quarter from \$20.9 billion in December. Still, with an order book of close to \$20 billion "even if some goes away it is a relatively comfortable position to be in," Mr. Curado said.

An Embraer Phenom 100 belonging to Jetbird, a Dublin-based taxi-jet service that has ordered 100 of the planes. Jetbird says executive jet travel is picking up after a sharp drop late last year.

For analysts, the decline in the order book is less worrying than the uncertainty over future orders.

"Weakness in Embraer's backlog is no surprise; the real question is how long the drought lasts and whether cancellations will accelerate before order flow recovers," a research note from Morgan Stanley said.

Business-jet makers including Bombardier of Canada, Dassault of France and Cessna in the United States have all reported falling orders, leading to production cuts and layoffs.

Sash Tusa, formerly an aerospace industry analyst with Goldman Sachs and now an independent aerospace consultant, says companies were slow to acknowledge the crisis.

"Many manufacturers have been in denial. They are only beginning to realize that the market is going down," he said.

There is "gross oversupply," and optimistic forecasts were made on false assumptions of market conditions, Mr. Tusa said. "Deliveries are up, but that's on what was sold two or five years ago. New orders are going into reverse."

Embraer delivered 204 aircraft in 2008, up 20 percent from 2007, including 162 commercial jets, 36 executive jets and 6 aircraft for defense and state institutions. But the outlook is uncertain.

Embraer's sales are roughly 65 percent commercial aircraft and 15 percent executive jets, with the remaining 20 percent split fairly evenly between defense and services.

The company expects to deliver 242 aircraft this year. In April, it delivered its first Phenom 100 aircraft to Executive AirShare, an aircraft share company in Kansas City, Missouri, that has firm orders for 44 Phenom 100s and six for the larger Phenom 300.

This month, the Dublin-domiciled Jetbird is due to receive its first delivery for an order of 100 Phenom 100s, 59 firm and 41 optional. Stefan Vilner, chief executive of Jetbird, confirmed that the September launch of the low-cost pan-European taxi-jet service was still on track despite the crisis. After a sharp fall in executive jet travel in the second half of last year, business is picking up again, he said.

"Most companies use business jets because they have to. How much does it cost to have senior executives sitting in an airport for hours? We can fly them with the efficiency and premium comfort of private jet travel at half the price," Mr. Vilner said.

As companies cut costs, including private jet travel, aircraft makers stand to lose.

"Business jets are essentially a luxury. Nobody needs a business jet to cross the Atlantic from the U.S. Eastern Seaboard to Western Europe," said Mr. Tusa. There is also a problem of social acceptability, he noted.

To overcome the weakness in civil aviation markets, Embraer has been shifting back toward its original military market.

In April, it announced two defense contracts. The first, estimated to be worth about \$1.3 billion, is to develop a new military transport aircraft for the Brazilian Air Force, with deliveries set to start in 2015. The second, smaller, contract with the Brazilian Navy is to modernize 12 McDonnell Douglas A-4 Skyhawk fighter jets.

Mr. Curado said: "Since 2007, we've been addressing more focus in the defense area, and it's starting to pay off a bit. Last year, it represented about 10 percent of our total sales. It will be a growing

business for us, but gradually, slowly. Maybe 10 percent will grow to 12 percent this year. We're targeting towards that."

There are also hopes that business will pick up on the commercial side.

In January, Embraer delivered the first of 30 E-Jets to Air Dolomiti, a regional carrier in northern Italy, owned by Lufthansa of Germany. The deal, announced in June 2007, is for 30 jets with deliveries expected to be completed by 2011.

Last month, Argentina's state-owned Austral Líneas Aéreas ordered 20 E-series aircraft. Brazil is reported to be providing the bulk of the financing for the estimated \$700 million sale. Analysts said the deal could at least slow Embraer's backlog decline through the second quarter. "Following this, however, we see no new potential orders of size for the foreseeable future," the Morgan Stanley research note said.

Embraer is also going ahead with an investment in two factories in Portugal to make aircraft frame parts and carbon fiber components. Production should start in 2012 to supply assembly lines back in Brazil. The project is of strategic importance for Embraer and will help to support customers worldwide, Mr. Curado said.

The investment could reach €170 million, or \$223.6 million, including up to €75 million in Portuguese government and local incentives, according to government officials. The factories will complement existing operations and service facilities in Brazil, the United States, France, Portugal, China and Singapore.

Embraer recently also added a service center in India for its Phenom and Legacy 600 jet customers, but prospects are uneven. "Asia has problems of overcapacity. There are huge orders and backlogs in Asia, which could lead to a higher rate of cancellations, but Latin America and Brazil are holding up well. The U.S. and Europe were not performing brightly in recent years, so the decline there is not so dramatic," Mr. Curado said.

Order growth is likely to remain modest in the next two years, but Mr. Curado believes Embraer is trim and fit enough to see through the downturn.

"We have a really sound product line," he said. "We are leaders in the segments where we operate. We have a modern, efficient product line and profitable products."