FITCH ASSIGNS 'BBB-' FIRST-TIME RATINGS TO EMBRAER; OUTLOOK STABLE

Fitch Ratings-New York-04 April 2016: Fitch Ratings has assigned first-time 'BBB-' foreign and local currency long-term Issuer Default Ratings (IDR), 'BBB-' unsecured ratings, and 'AAA(bra)' National Scale rating to Embraer S.A. (ERJ). Fitch has also assigned 'BBB-' unsecured ratings to debt issued by Embraer Netherlands Finance BV and Embraer Overseas Limited. The Rating Outlook is Stable.

Fitch's actions affect approximately $3.5 billion of debt outstanding as of Dec. 31, 2015. A full list of rating actions follows at the end of this release.

KEY RATING DRIVERS

Embraer's ratings reflect its competitive positions in the commercial and business jet markets; large backlog ($22.5 billion) covering several years of sales; consistent profitability; several promising defense programs; and the current favorable environment in the global commercial aviation industry. Embraer's solid liquidity profile, mostly held outside Brazil, and its large export revenues combined with some offshore operating cash flow further support the 'BBB-' ratings.

Rating concerns include significant competition in both the commercial and business jet markets; ongoing heavy investment and risks of potential delays related to new aircraft programs; new entrants into the commercial jet market; low operating margins in several business segments; and significant exposure to BNDES, as it finances more than 40% of Embraer's aircraft sales. Some of Embraer's credit metrics based on gross debt are weak for the ratings, but this weakness is offset by solid metrics on net debt basis, as well as the company's liquidity position. Off-balance sheet contingent obligations, mostly related to the weak market for regional jets with 50 or fewer seats, are also a concern, but this is mitigated by guarantee deposits partly collateralizing the exposure. The continuing SEC/DOJ investigation into potential violations of the Foreign Corrupt Practices Act is also incorporated into Fitch's analysis.

Brazil's economic and political environment is also a concern because the majority of Embraer's operating asset base is locally domiciled and Brazilian government spending has a potential impact on Embraer's Defense & Security business. Brazil is listed as a related party in ERJ's SEC filings as a result of the Brazilian government's 'golden share' and a direct shareholder stake (approximately 5% of Embraer) via a company controlled by the government. Nevertheless, Fitch believes that Embraer is partly insulated from its domestic environment because the bulk of its commercial markets are global. Approximately 88% of the company's revenue is generated from exports or from business operations based outside Brazil.

Fitch considers that Embraer's ratings could be at least one notch higher than Brazil's country ceiling if the country ceiling were downgraded; Brazil's country ceiling is currently 'BBB-'. This means a potential downgrade of Brazil's IDR ('BB+'/Negative Outlook) and a lowering of the country ceiling would not necessarily trigger a downgrade of Embraer's ratings.

CREDIT METRICS AND FREE CASH FLOW

Some of Embraer's credit metrics based on gross debt are weak for the ratings, but this weakness is offset by solid metrics on a net debt basis as a result of ERJ's zero net debt position at the end of 2015. Embraer's gross leverage (total debt/EBITDA) has increased steadily in recent years to approximately 4.70x as of Dec. 31, 2015, up from 3.02x and 2.19x at the end of 2014 and 2013, respectively. Adjusted leverage (total adjusted debt/EBITDAR) has similarly increased to 4.70x at the end of 2015, from 3.06x in 2014, and 2.24x in 2013. Embraer's adjusted net leverage (total adjusted net debt/EBITDAR) has also climbed from 0.45x at the end of 2013 to 1.36x as of December 2015. It is Fitch's policy to haircut certain financial investments for potential liquidity disadvantages compared to cash, and these haircuts are used in Fitch's calculations of net leverage metrics.

Much of the leverage increase can be attributed to debt issuance in 2015, with Embraer Netherlands BV issuing $1 billion in guaranteed notes due 2025. Embraer used the proceeds to build its liquidity position. Fitch expects debt to stay around the $3.5 billion level until an upcoming maturity in 2017.

Free cash flow (FCF; cash from operations less capex/development and dividends) has moved between positive and negative over the past four years, as capex and development costs for new aircraft programs have been high. In 2015, the company generated FCF of $32 million, up from a negative $315 million in 2014. Fitch expects FCF in 2016 will be modestly negative as a result of investment in the E2 program and the continuing production ramp up of the Legacy 450 and 500 business jets.

Fitch notes that the negative FCF seen in several of the past few years is not atypical for aerospace manufacturers in the middle of significant aircraft development programs. All of the other commercial aircraft manufacturers rated by Fitch have experienced similar periods of investment and negative FCF. Fitch expects dividends (a mandated percentage of income) will remain modest. The company has no defined benefit pension plan, so the large pension contributions seen at some other aerospace manufacturers rated by Fitch are not an issue at ERJ.

COMMERCIAL AEROSPACE

Embraer is the leader in the market for commercial jets with fewer than 130 seats. Its aircraft are known for their engineering, commonality across models, and interior design. The company delivered 101 commercial jets in 2015, up from 92 in 2014, and the commercial segment generated $3.3 billion of revenues with the highest margins among ERJ's business units. Fitch expects 2016 commercial deliveries will rise in the high single digits, and the company says its delivery slots are sold out for the year. ERJ had 513 firm orders in backlog at the end of 2015, including jets in the E2 family, and net orders in 2015 were 155 jets, for a solid 1.5x book to bill ratio.

Embraer has benefited from the upgauging trend and replacement demand in the airline industry, especially in the U.S. market, where several years ago scope clauses were relaxed, although these elements of pilot contracts still limit growth in the important U.S. market, in Fitch's view. The aircraft finance industry looks relatively favorably on Embraer's current EJet family, and financing sources have diversified over the past several years, with EJets serving as collateral in several capital markets transactions.

REPUBLIC AIRWAYS CHAPTER 11 FILING

The recent bankruptcy filing by one of Embraer's largest customers, Republic Airways, is a concern, but Fitch believes the impact is likely to be limited to some transaction guarantees related to Republic's fleet or ERJ 140 and 145 aircraft, which Fitch believes Embraer has the liquidity to cover. At the end of 2015, Republic owned or leased 185 EJETs (E170 and E175). It also had 74 ERJ 140 and ERJ 145 aircraft, some of which the company had parked or abandoned.

ERJ took a $100.9 million charge to cover estimated potential costs related to financial guarantees it provided to cover financing for Republic's ERJ 140/145 aircraft. Given the weak market for 50-

seat regional jets, Fitch expects this charge could rise modestly. ERJ has the liquidity to meet the estimated $100.9 million charge, and it is not clear how long the pay-outs might be spread over. Fitch believes the risk of guarantee losses on E170/175 aircraft is a lower risk given a statement in Republic's press release that its 'restructuring will maintain Republic as the world's largest operator of EJET aircraft.' The airline subsequently commented that it is attempting to focus its fleet on one aircraft type (E170/175).

Republic had 28 firm orders for E175's at the end of 2015. Given the importance of the E175 in the fleet plans of Republic's customers (American Airlines, Delta Airlines, and United Airlines), Fitch believes the most likely outcome is that there will be little impact on the E175 delivery schedule at Republic. The 60-day Section 1110 period will run through the latter part of April, and Fitch expects more information will be available regarding Republic's fleet plan and restructuring during that time period. Changes in Republic's relationships with its customers or failure to successfully restructure could affect Fitch's assumptions regarding ERJ's exposure to the bankruptcy, which could lead to a review of ERJ's ratings.

CONTINGENT OBLIGATIONS

Like most aerospace manufacturers, ERJ has a variety of off-balance sheet or contingent obligations because of the significant amount of debt used to finance aircraft deliveries. At the end of 2015, ERJ had maximum guarantees totalling $569 million (before provisions and before proceeds from the underlying assets), consisting of both financing guarantees and residual value guarantees (RVG's). The company also has some exposure to trade-in obligations. Fitch believes Embraer has the liquidity and cash flow to meet its potential obligations.

There are several factors that mitigate ERJ's potential exposure from the contingencies. First, ERJ has collateralized some of its guarantees with $577 million of guarantee deposits. Also, some of the exposure can possibly be reduced by selling the aircraft backed by the guarantees. Finally, there is a 'maturity schedule' to the guarantees, at least for the RVG's, in that the obligations are typically staggered over various future periods.

In its financial statement footnotes ERJ lists several special purpose vehicles (SPVs) which are related to aircraft finance transactions. ERJ has no equity interests in these SPVs, but the SPVs are consolidated because ERJ controls the SPVs' operations or takes a majority share of their risks and rewards. The value of the SPVs' assets on ERJ's balance sheet at the end of 2015 was $408 million, and the related debt was $384.8 million. The debt is serviced with the cash flows from the assets. The maturities of the debt go beyond 2020, but there is a large maturity of $332.6 million in 2019. In our credit analysis, we are treating the SPV debt as contingent obligations, so it is not included in adjusted debt calculations. Some of the guarantees and guarantee deposits discussed above apply to some of the SPVs.

Fitch estimates that the largest of the SPVs is Refine, Inc., and Fitch estimates the others are not material. Based on Fitch's analysis of information in the ASCEND aircraft database, Refine owns 57 aircraft, most of which are in service. The aircraft are mostly ERJ-145 models, with the remaining being ERJ-135's, according to Ascend, and the aircraft are up to 16 years old. ExpressJet, a U.S. regional airline which is part of SkyWest, is the operator of most of the aircraft, with Trans States operating the rest, per Ascend. Fitch estimates the planes are flown by ExpressJet as part of its contracts with American Airlines and United Airlines.

LIQUIDITY

At the end of 2015, Embraer had a liquidity position of $3.5 billion, consisting of cash and cash equivalents of $2.1 billion and financial investments of $1.4 billion. Embraer has a policy of maintaining healthy liquidity, which Fitch considers appropriate given the cost of periodic development programs and the nature of the commercial aerospace industry. Embraer does not have a revolving credit facility, which is not uncommon for Latin American corporate issuers.

In order to account for typical business requirements and potential short-term stresses, Fitch conservatively assumes Embraer requires a minimum of approximately $500 million of cash on hand. It is also Fitch's policy to haircut certain financial investments for potential liquidity disadvantages compared to cash, and these haircuts are used in Fitch's calculations of net leverage metrics.

Fitch notes that ERJ has $577 million in guarantee deposits to cover various guarantees; these deposits are not included in Fitch's liquidity calculation, but the deposits mitigate the risk of some off-balance sheet obligations.

Debt maturities are $219 million in 2016 and $424 million in 2017. The bulk of ERJ's debt matures beyond 2020. Approximately 23% of ERJ's debt is denominated in BRL.

Fitch views Embraer's financial flexibility to be relatively conservative, given its liquidity position. Fitch also recognizes that the company has increased the proportion of USD-to-total currency exposure from recent years, in the wake of the depreciating BRL. At the end of 2015, approximately 68% of the company's cash, equivalents and financial investments were in USD, compared to approximately 50% over the past several years.

KEY ASSUMPTIONS

Fitch's key assumptions within the rating case for Embraer include:

--The positive commercial aviation environment continues in 2016, but the business jet market shows little growth;
--Commercial deliveries and total revenues rise in the high single digits in 2016;
--Margins rise in 2016, with EBITDA in the low to mid-teens;
--ERJ generates marginally negative FCF over 2016 and 2017;
--Investment expenditures rise in 2016 and 2017 before declining in 2018;
--The U.S. dollar appreciates slightly in 2016 versus the Real.

RATING SENSITIVITIES

Fitch may consider negative rating actions in the event of significant delays and cost increases on the E2, KC-390 or other programs; failure to sufficiently reduce costs in the event of an aviation downturn or aviation shock (disease, terror, war, etc.); substantial order cancellations in the E1 and E2 programs; substantial declines in liquidity without commensurate debt reductions; or a multiple notch downgrade of Brazil's sovereign rating, along with a similar reduction in the country ceiling.

Financial metrics that could lead to a negative rating action include EBIT margin falling below 7%-8% for several years and funds from operations (FFO) adjusted net leverage remaining consistently above 2.0x.

Considerations that could lead to a positive rating action include successful retirement of risk in the development of the E2 and KC-390 programs, reduction in debt levels, or EBIT margin consistently above 9%.

FULL LIST OF RATING ACTIONS

Fitch has assigned the following ratings:

Embraer S.A.
--Foreign currency Issuer Default Rating (IDR) 'BBB-';
--Local currency IDR 'BBB-';
--Long-term National Rating Scale 'AAA(bra)';
--Senior unsecured debt 'BBB-'.

Embraer Overseas Limited
--Senior unsecured debt 'BBB-'.

Embraer Netherlands Finance BV
--Senior unsecured debt 'BBB-'.

The Rating Outlook is Stable.

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Applicable Criteria
Corporate Rating Methodology - Including Short-Term Ratings and Parent and Subsidiary Linkage (pub. 17 Aug 2015)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=869362
Country Ceilings (pub. 20 Aug 2015)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=869287
Evaluating Corporate Governance (pub. 07 Dec 2015)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=874784