MOODY'S
INVESTORS SERVICE

Rating Action: Moody's affirms Embraer's Baa3 ratings; outlook changed to negative

Global Credit Research - 10 Dec 2015

Approximately USD 2.2 billion of rated debt affected

New York, December 10, 2015 -- Moody's Investors Service (Moody's) affirmed Embraer S.A.'s foreign currency senior unsecured and issuer ratings at Baa3. The outlook was changed to negative from stable. This rating action follows Moody's decision on December 09, 2015 to place the Baa3 rating of Brazil's government bond under review for downgrade.

Ratings affirmed:

Embraer S.A.

-- Issuer Rating: Baa3 (domestic currency)

-- USD 500 million senior unsecured notes due 2022: Baa3 (foreign currency)

Embraer Overseas Limited

-- USD 23.6 million senior unsecured notes due 2017: Baa3 (foreign currency)

-- USD 162.8 million senior unsecured notes due 2020: Baa3 (foreign currency)

-- USD 540.5 million senior unsecured notes due 2023: Baa3 (foreign currency)

Embraer Netherlands Finance BV.

--USD 1,000 million Backed senior unsecured notes due 2025: Baa3 (foreign currency)

The outlook on all ratings was changed to negative from stable.

RATINGS RATIONALE

The affirmation of Embraer's ratings at Baa3 and outlook change to negative were prompted by Moody's decision to place Brazil's Baa3 government bond rating under review for possible downgrade. "Embraer has close links with the Brazilian federal government, but its significant revenue diversification, adequate liquidity and limited exposure to devaluation of local currency outweigh its exposure to the sovereign deterioration in the near term" says Cristiane Spercel, a Moody's Vice President - Senior Analyst.

Embraer's Baa3 rating currently ranks at the same level as Brazil's government bond rating. As per Moody's methodology "How Sovereign Credit Quality Can Affect Other Ratings", published on 16 March 2015, deterioration in sovereign credit quality can directly affect the credit standing of issuers domiciled within the country, but issuers with fundamentals that are much stronger than the sovereign could be rated above it on an exceptional basis. In the case of Embraer, this is evidenced by its leading position in the global market of regional jets, with a solid track record of control over operating costs and inventory management, which sustain healthy operating cash flows and strong financial metrics.

On the other hand, there are several links between the Embraer and the Brazilian federal government that could lead to increased pressure over the company's liquidity and financial profile in the near to medium term. Around 10% of the company's revenues are related to development and sales to the Brazilian Air Force and subject to the federal government's budget and eventual fiscal adjustments. Since 2014, the company has already been experiencing delays in the recovery of receivables and margin losses in certain government contracts. The Brazilian government holds a "golden share" of Embraer, which carries veto power over its corporate purposes, such as decisions to create or change the defense and security programs. Additionally, Embraer has historically relied on funding from Brazilian public banks to support exports to clients and its investment plan, which currently represent 15% of its total liabilities outstanding.

The cyclical nature of the aviation business and its growing competitive pressures also constrain Embraer's rating, because it requires significant investments on an ongoing basis to keep up with evolving customer needs. Working capital pressures and large capital expenditures will remain high through 2018, which will reduce its liquidity cushion and increase refinancing pressure over the next two years. In the absence of ample financing sourcing within the country, Embraer will be much more dependent on external banking financing and capital markets.

In addition to a solid market position and positive industry fundamentals, Embraer's strong liquidity cushion today is an important factor underpinning its rating. The company has consistently maintained a high level of cash balances approximating the level of its outstanding debt. At the end of September 2015, the company's cash-on-hand and short-term investments of BRL9.8 billion (USD2.5 million) approximated 70% of total adjusted debt and 2.5 times debt maturities through 2017. In June 2015, the company executed an anticipated liability management strategy with the issue of 10-year USD1.0 billion senior unsecured notes, and effective interest rate at 5.05% per year. As such, Debt to EBITDA leverage has spiked to 6.7x, but we expect it return to more normalized levels of 3.0x - 3.5x in 2016 and 2017. Nevertheless, Embraer's liquidity pressures will likely increase over the next few years, as a consequence of the aforementioned working capital pressures and large capital expenditures through 2018.

The negative rating outlook factors our expectation that Embraer's free cash flow (cash flow from operations after capex and dividend payments) will remain negative at least until 2018 due to the ongoing investments for commercial jet development coupled with some pricing pressures. Additionally, Embraer's working capital requirements may increase in the near term with challenges on its domestic exposure in the defense and security business, along with potential tax increases and/or reduction of fiscal incentives on production arising from the country's economic distress.

The rating could be downgraded in view of deterioration in Embraer's liquidity position, for example by an increase to a larger net debt position, without expectation of improvement in the near term. The rating would also be subject to negative pressure in view of weaker operating performance, such as operating margins consistently below 6% (5% in LTM 3Q15) or adjusted Debt to EBITDA above 3.5x (6.7x in LTM3Q15). The rating could also be pressured with industrial inefficiencies in production, insufficient mitigation of foreign exchange risk and/or any adverse development(s) with respect to the ongoing investigation by the SEC into possible violations of the Foreign Corrupt Practices Act.

A higher rating is unlikely at this time, but it could be considered if Embraer manages to sustain its leading position in the competitive regional jets market while maintaining operating profit margins steadily in the mid-teens range, adjusted Debt to EBITDA of less than 2.0x, and strong positive free cash flow (BRL300 million negative in LTM3Q15, after dividend payments). Maintenance of a strong liquidity profile also remains an important factor for any prospective rating improvement. A higher rating would be also dependent on Brazil´s sovereign ratings, so that the difference between the two ratings is not larger than one notch.

The principal methodology used in these ratings was Global Aerospace and Defense Industry published in April 2014. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

Headquartered in Sao Jose dos Campos, Brazil, Embraer is the leading manufacturer of regional jet airplanes (generally, up to 120 seats), with a growing defense & security segment and a line of business jets including new types for the mid-light and mid-size segments. In the last twelve months that ended September 30, 2015, Embraer generated approximately BRL17.6 billion (USD5.9 billion) in net revenues and BRL2.1 billion (USD700 million) in EBITDA. Founded in 1969 by the Brazilian federal government, the company was privatized in 1994 and transformed into a publicly-held corporation, subject to the provisions of Brazilian Corporate Law.

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