

EMBRAER BRAZILIAN AVIATION CO

Form 20-F

June 30, 2003

As filed with the Securities and Exchange Commission on June 30, 2003

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 20-F

**REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR 12(g)
OF THE SECURITIES EXCHANGE ACT OF 1934
OR**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended: December 31, 2002**

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934**

For the transition period from [] to []

Commission file number 1-15102

EMBRAER-EMPRESA BRASILEIRA DE AERONÁUTICA S.A.

(Exact name of Registrant as specified in its charter)

EMBRAER Brazilian Aviation Company Inc.

(Translation of Registrant's name into English)

Federative Republic of Brazil
(Jurisdiction of Incorporation)

**Avenida Brigadeiro Faria Lima, 2170
12227-901 São José dos Campos, São Paulo, Brazil**
(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of each class:

Preferred shares, without par value
American Depositary Shares (as evidenced by American Depositary
Receipts), each representing four preferred shares

Name of each exchange on which registered:

New York Stock Exchange*
New York Stock Exchange

*

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Not for trading purposes, but only in connection with the registration of American Depositary Shares pursuant to the requirements of the Securities and Exchange Commission.

Securities registered or to be registered pursuant to Section 12(g) of the Act.

None.

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act.

None.

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report:

242,544,448 common shares, without par value

470,429,907 preferred shares, without par value

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark which financial statement item the registrant has elected to follow.

Item 17 Item 18

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INTRODUCTION

In this annual report, Embraer, we, us or our refer to Embraer-Empresa Brasileira de Aeronáutica S.A. and its consolidated subsidiaries (unless the context otherwise requires). All references herein to the *real*, *reais*, or R\$ are to the Brazilian *real*, the official currency of Brazil. All references to US\$, dollars, or U.S. dollars are to United States dollars.

Presentation of Financial and Other Data

Financial Data

Our audited financial statements at and for the years ended December 31, 2000, 2001 and 2002 are included in this annual report and have been audited by Deloitte Touche Tohmatsu.

Our consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States, or U.S. GAAP. Because we export approximately 97.7% of our production and operate in an industry that uses the U.S. dollar as its currency of reference, management believes that the U.S. dollar is our functional currency and the most appropriate currency in which to present our financial statements. Accordingly, we decided to present our primary U.S. GAAP financial statements in U.S. dollars. As a result, amounts for all periods presented have been remeasured or translated into U.S. dollars in accordance with the methodology set forth in Statement of Financial Accounting Standards No. 52 (SFAS 52).

Prior to 2001, we presented our financial statements in accordance with accounting principles generally accepted in Brazil, or Brazilian GAAP, stated in Brazilian *reais* and adjusted for the effects of inflation. Previously, amounts of net income and shareholders' equity under Brazilian GAAP were reconciled to those that would have been reported under U.S. GAAP. Our financial statements and financial data presented herein and prepared in accordance with U.S. GAAP do not reflect the effects of inflation.

Pursuant to SFAS 52 as it applies to us, non-monetary assets and liabilities, including inventories, property, plant and equipment, accumulated depreciation and shareholders' equity are remeasured at historical rates of exchange, while monetary assets and liabilities denominated in currencies other than U.S. dollars are remeasured at period-end rates. Export sales invoiced in currencies other than the U.S. dollar are remeasured at the respective exchange rate on the date of sale. Cost of sales and services, depreciation and other expenses relating to assets remeasured at historical exchange rates are calculated based on the U.S. dollar values of such assets, and other non-U.S. dollar statement of income accounts are remeasured at the rate prevailing on the date of the charge or credit to income.

In our 2000, 2001 and 2002 financial statements, gains or losses resulting from the remeasurement of the financial statements and from foreign currency transactions have been reported in the consolidated statement of income as single line items. See Note 2.a to our consolidated financial statements.

Effective January 1, 2002, we decided to reclassify certain costs related to information technology, support, training and education as general and administrative expenses, instead of as cost of sales and services. All amounts for prior periods presented in this annual report have been restated to give effect to this reclassification. These reclassified costs equaled US\$9.8 million in 1998, US\$11.4 million in 1999, US\$21.3 million in 2000, US\$30.5 million in 2001 and US\$32.2 million in 2002. Effective January 1, 2002, we also began netting research and development related contributions that we receive from certain of our suppliers against our research and development expense, instead of recording these contributions as other operating income. All amounts for prior periods presented in this annual report have been restated to give effect to this reclassification. These reclassified amounts equaled US\$14.1 million in 2001 and US\$1.0 million in 2002.

For certain purposes, such as providing reports to our Brazilian shareholders, filing financial statements with the Comissão de Valores Mobiliários, or CVM, the Brazilian securities commission, and determining dividend payments and other distributions and tax liabilities in Brazil, we have prepared and will continue to be required to prepare financial statements in accordance with Law No. 6,404 of December 15, 1976, as amended, or the Brazilian

Corporate Law. Our financial statements prepared in accordance with the Brazilian Corporate Law are not adjusted to account for the effects of inflation.

As a result of the remeasurement of amounts to the functional currency and other adjustments related to the differences in accounting principles between U.S. GAAP and Brazilian GAAP, the amounts of net income and shareholders' equity as reported in our consolidated financial statements presented herein differ from those included in our statutory accounting records.

Other Data

Some of the financial data contained in this annual report reflects the effect of rounding. Aircraft ranges are indicated in nautical miles. One nautical mile is equal to approximately 1.15 ordinary or statute miles, or approximately 1.85 kilometers. Aircraft speeds are indicated in nautical miles per hour, or knots, or in Mach, which is a measure of the speed of sound. The term "regional jets" refers to narrow body jet aircraft with 20-110 passenger seats. The term "mid-capacity jets" refers to the 70-110 seat segment of regional jets.

We calculate the value of our backlog by considering all firm orders that have not yet been delivered. A firm order is a firm commitment from a customer, represented by a signed contract, customarily accompanied by a down payment, where we have reserved a place on one of our production lines. Every time we refer to our backlog in this annual report, we only make reference to firm orders, and not to options. When we refer in this annual report to the number or value of regional aircraft, we exclude one EMB 145 and two EMB 135s that were delivered to the Belgian government in 2001, one EMB 145 delivered to the Belgian government in 2002, and one EMB 135 aircraft that we delivered to the Greek government. These aircraft have been included in our defense data.

Special Note Regarding Forward-Looking Statements

This annual report includes forward-looking statements, within the meaning of Section 27A of the U.S. Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the U.S. Securities Exchange Act of 1934, as amended, or the Exchange Act, principally in Items 3 through 5 of this annual report. We have based these forward-looking statements largely on our current expectations and projections about future events and financial trends affecting our business. These forward-looking statements are subject to risks, uncertainties and assumptions, including, among other things:

general economic, political and business conditions, both in Brazil and in our markets;

management's expectations and estimates concerning our future financial performance, financing plans and programs, and the effects of competition;

successful development and marketing of the EMBRAER 170/190 jet family, our line of corporate jets and our defense aircraft;

our level of debt;

anticipated trends in our industry;

our expenditure plans;

inflation and devaluation;

our ability to develop and deliver our products on a timely basis;

availability of sales financing for our existing and potential customers;

(iii)

existing and future governmental regulation; and

other risk factors as set forth under Item 3D. Risk Factors.

The words believes, may, will, estimates, continues, anticipates, intends, expects and similar words are intended to identify forward-looking statements. We undertake no obligation 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 in this annual report might not occur. Our actual results could differ substantially from those anticipated in our forward-looking statements.

(iv)

PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISORS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

3A. Selected Financial Data

The following table presents our selected financial and other data at and for each of the periods indicated. The selected financial data at and for the three years ended December 31, 2000, 2001 and 2002 are derived from our consolidated U.S. GAAP financial statements audited by Deloitte Touche Tohmatsu, independent public accountants, included elsewhere in this annual report. The selected financial data at and for the year ended December 31, 1999 has been derived from our U.S. GAAP financial statements audited by Deloitte Touche Tohmatsu, independent accountants. The selected financial data at and for the year ended December 31, 1998 has been derived from financial statements originally prepared in accordance with Brazilian GAAP and audited by Arthur Andersen S/C, independent public accountants. This 1998 financial statement data has been restated in accordance with U.S. GAAP and is unaudited.

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At and for the year ended December 31,

	1998	1999	2000	2001	2002
(in thousands, except per share /ADS data)					
Income Statement Data					
Net sales	US\$ 1,353,541	US\$ 1,837,277	US\$ 2,762,162	US\$ 2,926,995	US\$ 2,525,800
Cost of sales and services	(970,224)	(1,248,675)	(1,879,318)	(1,769,234)	(1,531,720)
Gross profit	383,317	588,602	882,844	1,157,761	994,080
<i>Operating expenses</i>					
Selling expenses	US\$ (99,256)	US\$ (119,234)	US\$ (193,420)	US\$ (212,057)	US\$ (211,015)
Research and development	(39,749)	(18,808)	(69,593)	(99,566)	(158,499)
General and administrative	(50,166)	(55,948)	(96,645)	(120,787)	(109,673)
Employee profit sharing	(14,703)	(20,437)	(41,770)	(43,746)	(25,222)
Stock compensation	(4,334)	(2,436)	(510)	(1,074)	
Other operating expense, net	(3,431)	(3,629)	(19,518)	(29,463)	(20,498)
Equity on income (loss) from affiliates		(142)	753	310	389
Total operating expenses	US\$ (211,639)	US\$ (220,634)	US\$ (420,703)	US\$ (506,383)	US\$ (524,518)
<i>Income from operations</i>	US\$ 171,678	US\$ 367,968	US\$ 462,141	US\$ 651,378	US\$ 469,562
<i>Non-operating income (expense)</i>					
Interest income (expense)	US\$ (17,859)	US\$ 14,779	US\$ (6,874)	US\$ 47,502	US\$ 80,456
Financial transaction loss, net	(3,536)	(65,226)	(24,637)	(148,637)	(135,647)
Other non-operating income (expense), net	3,591	(13,361)	5,955	(8,426)	(1,394)
Total non-operating income (expense)	US\$ (17,804)	US\$ (63,808)	US\$ (25,556)	US\$ (109,561)	US\$ (56,585)
<i>Income before income taxes</i>	US\$ 153,874	US\$ 304,160	US\$ 436,585	US\$ 541,817	US\$ 412,977
Provision for income taxes	US\$ (8,587)	US\$ (69,620)	US\$ (117,379)	US\$ (218,394)	US\$ (188,502)
<i>Income before minority interest</i>	US\$ 145,287	US\$ 234,540	US\$ 319,206	US\$ 323,423	US\$ 224,475
Minority interest			1,522	(423)	(1,883)
<i>Income before cumulative effect of accounting change</i>	US\$ 145,287	US\$ 234,540	US\$ 320,728	US\$ 323,000	US\$ 222,592
Cumulative effect of accounting change, net of tax				5,440	
<i>Net income</i>	US\$ 145,287	US\$ 234,540	US\$ 320,728	US\$ 328,440	US\$ 222,592
Earnings per share					
Common share basic (1) (3) (6)	US\$ 0.27	US\$ 0.43	US\$ 0.55	US\$ 0.48	US\$ 0.30
Preferred share basic (1) (3) (6)	0.29	0.48	0.61	0.53	0.33
ADS basic (1) (3) (6)	1.18	1.90	2.43	2.11	1.32
Common share diluted (2) (3) (6)	0.27	0.38	0.48	0.46	0.30
Preferred share diluted (2) (3) (6)	0.29	0.42	0.53	0.50	0.33
ADS diluted (2) (3) (6)	1.17	1.66	2.10	2.01	1.31
Dividends per share					
Common share (3) (4) (5)	US\$ 0.031635	US\$ 0.085199	US\$ 0.249700	US\$ 0.254140	US\$ 0.193490
Preferred share (3) (4) (5)	0.034799	0.093719	0.274670	0.279560	0.212830
ADS (3) (4) (5)	0.139196	0.374876	1.098680	1.118240	0.851320

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Weighted averaged number of shares outstanding

Common share basic (3)		242,544		242,544		242,544		242,544		242,544
Preferred share basic (3)		272,590		272,590		308,401		402,035		454,414
Common share diluted (3)		242,544		242,544		242,544		242,544		242,544
Preferred share diluted (3)		274,441		347,064		392,954		433,386		459,415

Balance Sheet Data

Cash and cash equivalents	US\$	259,690	US\$	304,085	US\$	1,189,231	US\$	749,302	US\$	656,822
Other current assets		820,828		986,961		920,278		1,816,046		1,856,301
Property, plant and equipment, net		138,613		162,429		254,965		366,481		436,715
Other long-term assets		622,017		757,463		528,942		628,958		1,335,626
		<u> </u>		<u> </u>		<u> </u>		<u> </u>		<u> </u>
Total assets	US\$	1,841,148	US\$	2,210,938	US\$	2,893,416	US\$	3,560,787	US\$	4,285,464
		<u> </u>		<u> </u>		<u> </u>		<u> </u>		<u> </u>
Short-term loans		550,730		556,272		365,043		526,550		244,526
Other current liabilities		483,471		561,897		967,283		1,161,313		1,397,407
Long-term loans		124,038		80,597		90,969		245,186		308,110
Other long-term liabilities		513,232		647,271		677,013		599,212		1,237,015
Minority interest						7,748		8,170		8,226
Shareholders equity		169,677		364,901		785,360		1,020,356		1,090,180
		<u> </u>		<u> </u>		<u> </u>		<u> </u>		<u> </u>
Total liabilities and shareholders equity	US\$	1,841,148	US\$	2,210,938	US\$	2,893,416	US\$	3,560,787	US\$	4,285,464
		<u> </u>		<u> </u>		<u> </u>		<u> </u>		<u> </u>

At and for the year ended December 31,

	1998	1999	2000	2001	2002
(in thousands, except per share /ADS data)					
Other Financial Data					
Net cash provided by (used in) operating activities	US\$(28,442)	US\$(125,826)	US\$1,119,974	US\$(263,160)	US\$507,863
Net cash provided by (used in) financing activities	236,606	(5,632)	(130,398)	98,403	(200,790)
Net cash used in investing activities	(38,727)	(75,799)	(104,430)	(275,172)	(208,421)
Depreciation and amortization	21,046	25,076	30,596	46,417	55,602

- (1) Based on weighted average number of shares outstanding. See Note 27 to our consolidated financial statements.
- (2) Based on weighted average number of shares outstanding and the effects of potentially dilutive securities. See Note 27 to our consolidated financial statements.
- (3) Restated to give effect to the reverse stock split, on April 30, 1999, of one newly issued common or preferred share for 100 outstanding preferred shares or 100 outstanding common shares, respectively. Also restated to give effect to the issuance on March 1, 2002, in the form of a preferred share dividend, of 0.142106 new preferred share for each existing preferred or common share.
- (4) Includes interest on shareholders' equity.
- (5) Translated from nominal *reais* into U.S. dollars at the commercial selling rates in effect on the dates that distributions were declared during the period. The dividends to the ADSs were adjusted from the total amount paid to the preferred shares multiplied by four.
- (6) During 1999 and 2000, our results of operations benefited from changes we made to our valuation allowance related to deferred tax assets. Based on our assessment of future taxable income, we concluded that it was more likely than not that we would realize certain of these benefits given our improved profitability and increases in expected sales and backlog. The adjustments to the valuation allowances resulted in a decrease to income tax expense of US\$168.5 million in 1999 and US\$27.5 million in 2000. In addition, in 2001, we adopted SFAS No. 133 Accounting for Derivative Instruments and Hedging Activities, as amended. As a result, we recognized a gain of US\$5.4 million, net of related taxes, as a cumulative effect of a change in accounting. The following summarizes the earnings per share impact related to the above adjustments.

	1999	2000	2001
Effect of tax adjustments	US\$168,533	US\$27,539	
Effect of cumulative effect of change in accounting			5,440
Total	168,533	27,539	5,440
Basic earnings per common share	0.31	0.05	0.01
Basic earnings per preferred share	0.34	0.05	0.01
Basic earnings per ADS	1.37	0.21	0.04
Diluted earnings per common share	0.27	0.04	0.01
Diluted earnings per preferred share	0.30	0.05	0.01
Diluted earnings per ADS	1.20	0.19	0.04

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At and for the year ended December 31,

	1998	1999	2000	2001	2002
Other Data:					
Aircraft delivered during period:					
To the Regional Market					
EMB 120 Brasília	13	7		2	
ERJ 145	60	80	112	104	80
ERJ 135		16	45	27	3
ERJ 140				22	36
To the Defense Market					
EMB 120 Brasília	1				
Legacy					1
EMB 135			1	2	
EMB 145				1	1
EMB 145 AEW&C/RS/MP					5
EMB 312 Tucano	6				
AM-X	10	3	1		
To the Corporate Market					
Legacy					8
EMB 135			2	5	
To the General Aviation Market					
Light Aircraft	26	17	17	11	25
	<u>116</u>	<u>123</u>	<u>178</u>	<u>174</u>	<u>161</u>
Total delivered	116	123	178	174	161
Aircraft in backlog at the end of period:					
In the Regional Market(1)					
EMB 120 Brasília	7		2		
ERJ 145	131	176	261	159	109
ERJ 135	134	124	85	53	31
ERJ 140			133	152	116
EMBRAER 170		40	90	82	88
EMBRAER 195		30	30	30	30
In the Defense Market					
EMB 145 AEW&C/RS/MP	8	12	12	15	10
EMB 312 Tucano/EMB 314 Super Tucano				86	86
AM-X	4	1			
EMB 145			2	1	
EMB 135		1	2	1	
In the Corporate Market					
Legacy/EMB 135			29	66	58
In the General Aviation Market					
Light aircraft		2			
	<u>284</u>	<u>386</u>	<u>646</u>	<u>645</u>	<u>528</u>
Total backlog (in aircraft)	284	386	646	645	528
Total backlog (in millions)	US\$4,112	US\$6,365	US\$11,421	US\$10,693	US\$9,034

(1) Subsequent to December 31, 2002, we received 126 net additional firm orders for our EMBRAER 170/190 jet family.

Exchange Rates

There are two foreign exchange markets in Brazil that are subject to regulation by the Brazilian Central Bank, or the Central Bank, both of which operate at free-floating rates:

the free rate foreign exchange market, also known as the commercial market, and

the floating rate foreign exchange market.

In 1999, the Central Bank unified the operational limits applicable to both markets. However, each market continues to have a specific regulation. Most trade and financial foreign exchange transactions, including transactions relating to the purchase or sale of preferred shares or the payment of dividends with respect to preferred shares or ADSs, are carried out on the commercial market at the applicable commercial market rate. Purchase of foreign currencies in the commercial market may be carried out only through a Brazilian bank authorized to buy and sell currency in that market. In both markets, rates are freely negotiated but may be strongly influenced by Central Bank intervention.

Between March 1995 and January 1999, the Central Bank permitted the gradual devaluation of the *real* against the U.S. dollar pursuant to an exchange rate policy that established a band within which the *real*/U.S. dollar exchange rate could fluctuate.

Responding to pressure on the *real*, on January 13, 1999, the Central Bank widened the foreign exchange band. Because the pressure did not ease, on January 15, 1999, the Central Bank allowed the *real* to float freely. The *real* reached a low of R\$1.4659 per US\$1.00 on January 15, 1999 and a high of R\$3.9552 per US\$1.00 on October 22, 2002. At June 16, 2003, the commercial market rate for purchasing U.S. dollars was R\$2.8508 to US\$1.00. We cannot assure you that the *real* will not appreciate or devalue substantially in the near future.

The following table shows the commercial selling rate for U.S. dollars for the periods and dates indicated.

Exchange Rate of <i>Reais</i> to US\$1.00				
	Low	High	Average (1)	Period-end
Year ended December 31,				
1998	1.1165	1.2087	1.1611	1.2087
1999	1.2078	2.1647	1.8158	1.7890
2000	1.7234	1.9847	1.8295	1.9554
2001	1.9357	2.8500	2.3532	2.3204
2002	2.2709	3.9552	2.9309	3.5333

Exchange Rate of <i>Reais</i> to US\$1.00		
	Low	High
Month ended		
December 31, 2002	3.4278	3.7980
January 31, 2003	3.2758	3.6623
February 28, 2003	3.4832	3.6580
March 31, 2003	3.3531	3.5637
April 30, 2003	2.8898	3.3359
May 31, 2003	2.8653	3.0277
June 30, 2003 (through June 16)	2.8504	2.9776

Source: Central Bank.

(1) Represents the daily average exchange rate during each of the relevant periods.

We will pay any cash dividends and make any other cash distributions with respect to the preferred shares in Brazilian currency. Accordingly, exchange rate fluctuations may affect the U.S. dollar amounts received by the

holders of ADSs on conversion by the depository of such distributions into U.S. dollars for payment to holders of ADSs. Fluctuations in the exchange rate between the *real* and the U.S. dollar may also affect the U.S. dollar equivalent of the *real* price of the preferred shares on the São Paulo Stock Exchange.

3B. Capitalization and Indebtedness

Not applicable.

3C. Reasons for the Offer and Use of Proceeds

Not applicable.

3D. Risk Factors

Risks Relating to Embraer

A downturn in the regional aircraft market may reduce our sales and revenue, and consequently our profitability, in any given year.

We expect that a substantial portion of our sales in the near future will be derived from sales of regional aircraft, particularly the ERJ 145 regional jet family and the EMBRAER 170/190 jet family. Historically, the market for regional aircraft has been cyclical due to a variety of factors that are both external and internal to the air travel industry, including general economic conditions.

The commercial aviation industry has been negatively impacted by a number of factors beginning in 2001. First, the U.S. and world economies have been experiencing an economic downturn that began in 2001 and is characterized by rapid declines in securities markets, a decline in productivity and an increase in unemployment. Second, the terrorist attacks of September 11th caused an immediate decline in airline travel and a high level of financial uncertainty among the worldwide airline industry. Many airlines faced, and continue to face, a reduction in demand, escalating insurance costs, increased security costs, increasing fuel costs and, in some cases, credit downgrades, liquidity concerns and bankruptcy. Finally, airline travel decreased significantly in 2003 as a result of both the commencement of military action by the United States and other countries in Iraq and the concerns over outbreaks of severe acute respiratory syndrome (SARS) in Asia and Canada. In response to these events, beginning in the fourth quarter of 2001 many airlines, including our largest customers, reduced their flight schedules for the long-term and announced significant lay-offs. As a result, we have agreed to modify certain delivery schedules to adjust to the changes in our customers' businesses and have reduced scheduled regional, corporate jet and government transportation aircraft deliveries in 2002 to 131 aircraft as compared to planned 2002 deliveries of 205 at August 31, 2001 and reduced 2003 scheduled deliveries to 110 aircraft from planned 2003 deliveries of 148 as of December 31, 2002. We have also re-evaluated our risk exposure related to aircraft valuations and customer credit risk, which resulted in charges to income. A further downturn in general economic conditions could result in further reduction in the passenger aircraft market and decreased orders for our regional aircraft.

We cannot, at this time, predict the magnitude or duration of the impact that the above events will have on the airline industry as a whole and on our business in particular. If one of our customers experiences a business downturn, cannot obtain financing or otherwise seeks to limit its capital expenditures, that customer could defer or cancel its purchase of our regional aircraft or change its operating requirements. Because our regional aircraft represent the majority of our net sales, sales of our other products would not be able to offset a reduction in sales of our regional aircraft. Future delays or decreases in the number of regional aircraft delivered in any year would likely reduce our sales and revenue, and consequently our profitability, for that year.

We depend on a small number of key customers and key suppliers, the loss of any of which could harm our business.

Civil aircraft. We rely on a limited number of customers for a substantial portion of our total net sales. As of June 30, 2003, our largest customers were ExpressJet, American Eagle, JetBlue Airways, US Airways, Wexford and Swiss International Airlines, Ltd., or SWISS. At the same date, 78.5% of our firm orders in backlog for the ERJ 145 were attributable to ExpressJet, 55.3% of our options for the ERJ 145 were attributable to ExpressJet and US Airways, and 81.1% of our firm orders and 55.6% of our options for the ERJ 140 were from American Eagle. In addition, at June 30, 2003, JetBlue Airways, US Airways and GE Capital Aviation Services together represented 77.9% of firm orders in backlog and 80.9% of options for the EMBRAER 170/190 jet family, and 65.5% of our firm orders in backlog and 61.0% of our options for the Legacy, our new line of corporate jets, were from Swift Aviation Services. We believe that we will continue to depend on a limited number of large customers, the loss of any of which could reduce our sales and reduce our market share. Fewer sales could reduce our profitability.

Defense aircraft. The Brazilian Air Force is our largest customer of defense aircraft products. Sales to the Brazilian government accounted for 31.8% of our defense sales for the year ended December 31, 2002. A decrease in defense spending by the Brazilian government due to defense spending cuts, general budgetary constraints or other factors that are out of our control could decrease our defense sales and defense research and development funding. Given past statements by the Brazilian government of its intent to reduce its overall level of spending, we cannot assure you that the Brazilian government will continue to purchase aircraft or services from us in the future at the same rate or at all.

Key suppliers. Our risk-sharing partners develop and manufacture significant portions of our aircraft, including the engines, hydraulic components, avionics, wings, interior and parts of the fuselage and tail. Once risk-sharing partners have been selected and program development and aircraft production have begun, it is difficult to substitute these partners. In some cases, the aircraft are designed specifically to accommodate a particular component, such as the engines, which cannot be substituted by another manufacturer without significant delays and expense. This dependence makes us susceptible to the risks of performance, product quality and financial condition of these risk-sharing partners.

We cannot assure you that we will not experience significant delays in obtaining key equipment in our manufacturing process in the future. Although we work closely with and monitor the production process of our risk-sharing partners and suppliers, the failure of our risk-sharing partners and other major suppliers to meet our performance specifications, quality standards or delivery schedules could affect our ability to deliver new aircraft to customers in a timely manner.

Any decrease in Brazilian government-sponsored customer financing, or increase in government-sponsored financing that benefits our competitors, may decrease the cost-competitiveness of our aircraft.

Historically, when purchasing our aircraft, our customers have benefited from export financing incentives provided by Brazilian government-sponsored export programs. The most important of these government programs is a system of interest rate adjustments called the Programa de Financiamento às Exportações, or Export Financing Program, known as the ProEx program.

In July 1998, the Canadian government initiated a proceeding at the World Trade Organization, or WTO, accusing the Brazilian government of granting prohibited export subsidies relating to sales of aircraft to foreign purchasers under the ProEx program. The Brazilian government countered, accusing the Canadian government of granting prohibited export subsidies to the Canadian aircraft industry. On April 14, 1999, the WTO declared the portions of the ProEx program relating to Brazilian aircraft financing, and some aspects of the Canadian aircraft financing programs, to be prohibited export subsidies. Following appeals, the WTO formally decided on August 20, 1999 to give Brazil until November 18, 1999 to withdraw the prohibited export subsidies or make any necessary adjustments to bring the program into compliance with WTO rules. On April 28, 2000, the WTO concluded that Brazil had failed to comply with the earlier ruling to remove prohibited subsidies by November 18, 1999. In particular, the WTO concluded that the issuance of ProEx benefits after November 18, 1999 pursuant to letters of commitment issued by the Brazilian government to our customers prior to November 18, 1999 were prohibited export subsidies. The WTO also concluded that the amended version of the ProEx program, adopted in response to

the WTO's August 1999 ruling, still decreased effective interest rates for regional aircraft to below commercial market levels and thus continued to provide a prohibited export subsidy. In July 2000, the WTO confirmed this decision after an appeal by the Brazilian government. The Brazilian government publicly announced that it would honor its contractual commitments to our customers. As a result of Brazil's continuing to provide ProEx benefits under its contractual commitments, the WTO dispute settlement body granted Canada the authority to impose up to US\$1.4 billion in trade sanctions over five to six years against Brazil. Canada has not yet imposed sanctions. We cannot predict what form, if any, these sanctions will take and whether such sanctions will adversely affect our business. The Brazilian government subsequently amended the ProEx program so that any ProEx payments would not decrease the effective interest rate below the interest rate permitted by the WTO. On August 23, 2001, the dispute settlement body of the WTO determined the revised ProEx program was in full compliance with WTO rules.

Although this ruling confirms ProEx's compliance with WTO rules, the ProEx program or other export financing programs available to our customers may be subject to challenge in the future. If the ProEx program or another similar program is not available in the future, or if its terms are substantially reduced, our customers' financing costs could be higher and our cost-competitiveness in the regional jet market could decrease.

In 2001, the Canadian government agreed to provide up to US\$1.1 billion of low-interest financing to Air Wisconsin, an affiliate of United Airlines, to fund its purchase of Bombardier regional jets. The Brazilian government challenged these subsidies and, in January 2002, a WTO panel declared that such subsidies were illegal and required Canada to withdraw the funds. The panel also found that, since 1996, two airlines in addition to Air Wisconsin had been recipients of illegal subsidies. As a result, the dispute settlement body of the WTO authorized Brazil to apply retaliatory measures against Canada in the amount of US\$248 million. Officials of the Canadian government have indicated that they intend to continue providing support to Bombardier. Any future subsidies supporting Bombardier or any of our other major competitors may cause the cost-competitiveness of our aircraft to suffer and our sales to decline.

The Brazilian and Canadian governments have entered into negotiations regarding government support for aircraft exports. We cannot assure you that any agreement will be reached.

Brazilian government budgetary constraints could reduce amounts available to our customers under government-sponsored financing programs.

In addition to the ProEx program, we rely on the BNDES-*exim* program, also a government-sponsored financing program, to assist customers with financing. This program provides our customers with direct financing for Brazilian exports of goods and services. At December 31, 2002, approximately 48.0% of our backlog (in terms of value) was subject to financing by the BNDES-*exim* program. As government-sponsored programs, the ProEx program and the BNDES-*exim* program rely on funds allocated from the Brazilian national budget. Therefore, the funds available to our customers under these programs will be affected by currency fluctuations and other political and economic developments in Brazil and the international capital markets. See Risks Relating to Brazil. For example, a decrease in the amounts available under the ProEx program caused us to make other financing arrangements for affected customers. In addition, from time to time, government-sponsored financing programs such as ProEx or BNDES-*exim* can be subject to challenge. We cannot assure you that the Brazilian government will continue to sponsor and/or fund these programs or that funds under these or other similar programs will be available to our customers. The loss or significant reduction of funds available under one or either of these programs, without an adequate substitute, could lead to fewer sales and has caused and may continue to cause us to compensate our customers for their additional financing costs, resulting in lower profitability for Embraer.

We face a number of challenges resulting from the development of new products and our expansion into new markets.

As we continue to develop the EMBRAER 170/190 jet family, we will have to continue reallocating existing resources and coordinating with new suppliers and risk-sharing partners. We also need to recruit, retain and motivate additional highly skilled engineers and other personnel to assist us in our research and development activities, which are essential to the success of our current and future programs. There is significant competition within the aviation industry for skilled personnel in general and engineers in particular. As a result, we may be unable to recruit the necessary number of highly skilled engineers and other personnel we require. Failure to

coordinate our resources in a timely manner or to attract and retain skilled personnel could impede our development efforts and cause delays in production and deliveries of our aircraft, which would delay recognition of revenue.

Finally, we may pursue strategic growth opportunities, including joint ventures, acquisitions or other transactions, to expand our business or enhance our products and technology. We may face a number of challenges, including difficulties in identifying appropriate candidates, assimilating their operations and personnel and maintaining internal standards and controls, as well as the diversion of our management's focus from our ongoing business. We cannot assure you that we will be able to meet these challenges or that our business will not face disruptions.

We may have to refund cash contributions after the development of the EMBRAER 170/190 jet family if certification for these aircraft is not obtained.

Our risk-sharing partners have contributed to us a total of US\$250.6 million for the development of the EMBRAER 170/190 jet family as of December 31, 2002. If we cancel the development and production of the EMBRAER 170/190 jet family because we are unable to obtain certification or for other non-market related reasons, we may be obligated to refund all or a part of these cash contributions. If we require additional financing and we are unable to obtain it, we will not be able to develop and market our EMBRAER 170/190 jet family.

Our aircraft sales are subject to cancellation provisions, repurchase and trade-in options and financial and residual value guarantees that may reduce our cash flow or require us to make significant cash disbursements in the future.

A portion of our aircraft firm orders is subject to significant contingencies, both before and after delivery. Prior to delivery, some of our purchase contracts may be terminated, or all or a portion of a particular firm order may be canceled, for different reasons, including:

extended delays in delivering aircraft or failure to obtain certification of the aircraft or otherwise meet performance milestones and other requirements;

failure of the customer to receive financing, when required, with respect to any aircraft by the scheduled delivery date of such aircraft, in which case the customer could cancel the order for the particular aircraft to be financed or terminate the contract with respect to all undelivered aircraft; or

exceeding production rate limits.

Our customers may also reschedule deliveries, particularly during an economic downturn. A substantial number of cancellations or extensions of delivery schedules could reduce our sales and revenue for a given year, which in turn would reduce our cash flow.

We may also have to repurchase a number of our aircraft. Under the relevant purchase contracts, the price per aircraft of any required repurchase is less than the original purchase price of the aircraft and less than our estimate at that time of the market value of the relevant aircraft type in future years (based on third party appraisals of aircraft valuations). If we are required to repurchase all of the relevant aircraft under our repurchase obligation, which covers the period from 2003 to 2007, we could be required to pay up to approximately US\$500 million for these aircraft.

At December 31, 2002, 34 of our regional jets were subject to trade-in options and additional aircraft may become subject to trade-in options upon delivery. These options provide that the trade-in price can be applied to the price of an upgraded model or any of our other aircraft. The trade-in price is determined in the manner discussed above for regional jets and as a percentage of the original purchase price for our corporate jets. We may be required to accept trade-ins at trade-in prices that are above the then-market price of the aircraft, which would result in financial loss for us when we resell the aircraft.

We also have guaranteed the financial performance of a portion of the financing for, and the residual value of, some of our aircraft that have already been delivered. Financial guarantees are provided to financing parties to support a portion of the payment obligations of our customers under their financing arrangements to mitigate default-related issues. These guarantees are collateralized by the financed aircraft. Our residual value guarantees typically ensure that in the 15th year after delivery, the relevant aircraft will have a residual market value of 10% to 27% of the original sale price. In the event of a decrease in the market value of the underlying aircraft, we will bear the difference between the then market value of the aircraft and the guaranteed residual value.

Assuming all customers supported by financial guarantees defaulted on their aircraft financing arrangements, we were required to pay the full aggregate amount of outstanding residual value guarantees and we were not able to sell or lease any of the aircraft to offset our obligations, our maximum exposure under these guarantees (less provisions and liabilities) would have been US\$1.4 billion as of December 31, 2002. See Note 37 to our consolidated financial statements for a further discussion of these off-balance sheet arrangements. We have deposited US\$187.4 million in escrow accounts to secure a portion of our financial guarantees. Although we believe that the estimated value of the covered aircraft, on an aggregate basis, is currently sufficient to cover our exposure, we may be obligated to make substantial payments that are not recoverable through proceeds from aircraft sales or leases, particularly if the future value of the relevant aircraft is significantly lower than the guaranteed amount or financing defaults occur with respect to a significant portion of our aircraft. The value of the underlying aircraft is more likely to decrease and third parties are more likely to default during economic downturns such as we are currently experiencing.

We recorded a charge against income of US\$14.5 million in 2002, based on our risk assessment, on an individual aircraft basis, of our guarantees. We continually re-evaluate our risk under guarantees and repurchase and trade-in obligations based on a number of factors, including the estimated future market value of our aircraft based on third party appraisals, including information developed from the sale or lease of similar aircraft in the secondary market, and the credit rating of customers. Any future decrease in the market value of the aircraft covered by repurchase obligations, trade-in rights or guarantees would decrease our ability to recoup the amounts payable to satisfy our obligations and cause us to incur additional charges to income. If we are required to pay amounts related to such guarantees or repurchase obligation, we may not have sufficient cash or other financial resources available to do so and may need to seek financing to fund these payments. We cannot assure you that then-prevailing market conditions would allow us to resell or lease the underlying aircraft at its anticipated fair value or in a timely manner. Consequently, honoring our repurchase, trade-in or guarantee obligations could require us to make significant cash disbursements in a given year, which in turn would reduce our cash flow in that year.

We face significant international competition, which may adversely affect our market share.

The worldwide regional jet aircraft manufacturing industry is highly competitive. We are one of the leading manufacturers of commercial aircraft in the world, along with The Boeing Company, Airbus Industrie and Bombardier Inc., all of which are large international companies. These and other of our competitors have greater financial, marketing and other resources than we do. Although we have achieved a significant share of the market for our regional aircraft products, we cannot assure you that we will be able to maintain this market share. Our ability to maintain market share and remain competitive in the regional jet aircraft market over the long term requires continued technological and performance enhancements to our products. Our primary competitor in the regional jet market is Bombardier Inc., a Canadian company, which has significant technological capabilities, financial and marketing resources and benefits from government-sponsored export subsidies. In addition, other major international aircraft manufacturers, including The Boeing Company and Airbus Industrie, produce or are developing aircraft at the high end of the 81-110 seat segment, increasing the competitive pressures in that segment. These companies also have significant technological capabilities and greater financial and marketing resources.

Some of our competitors may also reach the market before we do, allowing them to establish a customer base and making our efforts to gain greater market share more difficult. For example, Bombardier recently commenced delivery of its 70-seat regional jet prior to the initial deliveries of the EMBRAER 170. As a new entrant to the corporate jet market, we also face significant competition from companies with longer operating histories and established reputations in this industry. We cannot assure you that we will be able to compete successfully in our markets in the future.

We may have to make significant payments as a result of unfavorable outcomes of pending challenges to various taxes and social charges.

We have challenged the constitutionality of the nature of and modifications in rates and the increase in the calculation base of certain Brazilian taxes and social charges. Interest on the total amount of these unpaid taxes and social charges accrues monthly based on the Selic rate, the key lending rate of the Central Bank, and we make an accrual as part of the interest income (expense) item of our statements of income. As of December 31, 2002, we had obtained preliminary injunctions for not paying or recovering past payments in the total amount, including interest, of US\$186.9 million, which is included as a liability on our balance sheet. We cannot assure you that we will prevail in these proceedings or that we will not have to pay significant amounts, including penalties and interest, to the Brazilian government in the future as payment for these liabilities.

Risks Relating to the Regional Aircraft Industry

Scope clause restrictions in airline pilot contracts may limit demand for regional jets in the U.S. market.

A key limiting factor in demand for regional jets is the existence of scope clauses contained in airline pilot contracts. These scope clauses are union-negotiated restrictions on the number and/or size of regional aircraft that a particular carrier may operate. Current scope clause restrictions, which are more prevalent in the United States, include restrictions on the number of seats, weight of aircraft and number of regional jets in an airline's fleet. Most scope clauses are aimed at limiting 50-70 seat jets. As a result, our opportunities for near-term growth in the U.S. regional jet market in the 40-59 and 60-80 seat segments are limited. The continuation or further tightening of scope clauses could also lead some of our customers who have purchased options to acquire our regional jets not to exercise those options. We cannot assure you that current restrictions will be lessened, or will not be expanded, including by amending these scope clauses to cover larger-sized regional aircraft. Furthermore, although scope clauses are less prevalent outside the United States, we cannot assure you that scope clauses will not become more prevalent or restrictive, or that some other form of restriction will not take effect, in Europe or in other markets.

We are subject to stringent certification requirements and regulation, which may delay our obtaining certification in a timely manner.

Our products are subject to regulation in Brazil and in each jurisdiction where our customers are located. The aviation authorities in Brazil and in other countries in which our customers are located, including the Brazilian aviation authority, the FAA, the Joint Aviation Authority of Europe, the European aviation authority, and the Chinese aviation authority, must certify our aircraft before we can deliver them. A recommendation by the European aviation authority is a requirement for certification of an aircraft by the aviation authorities of most European countries. We cannot assure you that we will be able to obtain certification of our aircraft on a timely basis or at all. If we fail to obtain a required certification from an aviation authority for any of our aircraft, that aviation authority would prohibit the use of that aircraft within its jurisdiction until certification has been obtained. In addition, complying with the requirements of the certification authorities can be both expensive and time-consuming. Changes in government regulations and certification procedures could also delay our start of production as well as entry into the market. We cannot predict how future laws or changes in the interpretation, administration or enforcement of laws will affect us. We may be required to spend significantly more money to comply with these laws or to respond to these changes.

Any catastrophic events involving our aircraft could adversely affect our reputation and future sales of our aircraft, as well as the market price of the preferred shares and the ADSs.

We believe that our reputation and the safety record of our aircraft are important selling points for our aircraft. We design our aircraft with backup systems for major functions and appropriate safety margins for structural components. However, the safe operation of our aircraft depends to a significant degree on a number of factors largely outside our control, including our customers' proper maintenance and repair of our aircraft and pilot skill. Due to our relative position in the aircraft market and because we have focused on products in the regional aircraft segment, the occurrence of one or more catastrophic events involving one of our aircraft could adversely affect our entire regional jet family as well as our reputation and future sales.

Risks Relating to Brazil

Brazilian political and economic conditions have a direct impact on our business and the market price of our preferred shares and the ADSs.

The Brazilian economy has been characterized by frequent, and occasionally drastic, intervention by the Brazilian government and by volatile economic cycles. The Brazilian government's actions to control inflation and affect other policies have involved wage and price controls, currency devaluations, capital controls and limits on imports, among other things. Our business, financial condition, results of operations and the market price of the preferred shares and the ADSs may be adversely affected by changes in policy involving tariffs, exchange controls and other matters, as well as other factors outside of our control such as:

- fluctuations in exchange rates;
- base interest rate fluctuations;
- inflation and price instability;
- liquidity of domestic capital and lending markets;
- tax policy;
- structural and investment deficiencies in the energy sector; and

other political, diplomatic, social and economic developments in or affecting Brazil.

Rapid changes in Brazilian political and economic conditions that have already occurred and that might continue will require continued emphasis on assessing the risks associated with our activities and adjusting our business and operating strategy. Future developments in Brazilian government policies, including changes in the current policy and incentives adopted for financing the export of Brazilian goods, or in the Brazilian economy, over which we have no control, may materially adversely affect our business, financial condition and results of operations.

Our business could be significantly affected by political instability in Brazil. In the elections in October 2002, Brazilian voters elected a new president from the Workers Party, Luís Inácio Lula da Silva, known as Lula. In the period leading up to and following his election, there was substantial uncertainty relating to the policies that the new government would pursue, including the potential implementation of macroeconomic policies that differed significantly from those of the prior administration. This uncertainty resulted in a loss of confidence in the Brazilian capital markets and the continued devaluation of the *real*. Although the new government has not yet departed in any material way from previous policies, it is premature to determine what policies might be implemented, whether these policies will be effective and how investors and the capital markets will react to them. Any substantial negative reaction to the policies of the Brazilian government could adversely affect our business, operations and the market price of our preferred shares and ADSs.

Inflation and certain governmental measures to combat inflation may contribute significantly to economic uncertainty in Brazil and to heightened volatility in the Brazilian securities markets and, consequently, may adversely affect the market value of the preferred shares and the ADSs.

Brazil has historically experienced extremely high rates of inflation. Inflation itself, certain governmental measures to combat inflation and public speculation about possible future measures have in the past had significant negative effects on the Brazilian economy, contributing to economic uncertainty in Brazil and to heightened volatility in the Brazilian securities markets.

Since the *real*'s introduction in July 1994 under the *Real Plan*, Brazil's inflation rate has been substantially lower than in previous periods. If Brazil experiences substantial inflation again in the future, our operating expenses

and borrowing costs may increase, our operating and net margins may decrease and, if investor confidence decreases, the price of the preferred shares and ADSs may fall.

Exchange rate instability may result in uncertainty in the Brazilian economy and the Brazilian securities market and could lower the market value of the preferred shares and the ADSs.

Although most of our net sales and debt are U.S. dollar-denominated, the relationship of the *real* to the value of the U.S. dollar, and the rate of devaluation of the *real* relative to the prevailing rate of inflation, may adversely affect us.

As a result of inflationary pressures, the Brazilian currency has been devalued periodically during the last four decades. Throughout this period, the Brazilian government has implemented various economic plans and utilized a number of exchange rate policies, including sudden devaluations, periodic mini-devaluations during which the frequency of adjustments has ranged from daily to monthly, floating exchange rate systems, exchange controls and dual exchange rate markets. From time to time, there have been significant fluctuations in the exchange rates between the Brazilian currency and the U.S. dollar and other currencies. More recently, the *real* devalued against the U.S. dollar by 9.3% in 2000 and 18.7% in 2001. During 2002, the *real* continued to undergo significant devaluation due in part to continued economic and political uncertainties in emerging markets and the global economic slowdown. In 2002, the depreciation of the *real* relative to the U.S. dollar totaled 52.3%. In the first five months of 2003, the *real* appreciated 16.1%.

Devaluations of the *real* relative to the U.S. dollar would reduce the U.S. dollar value of distributions and dividends on the ADSs and may also reduce the market value of the preferred shares and the ADSs. Devaluations also create additional inflationary pressures in Brazil by generally increasing the price of imported products and requiring recessionary government policies to curb aggregate demand. On the other hand, appreciation of the *real* against the U.S. dollar may lead to a deterioration of the current account and the balance of payments, as well as dampen export-driven growth. The potential impact of the floating exchange rate and of measures of the Brazilian government aimed at stabilizing the *real* is uncertain.

Developments in other countries, particularly other emerging market countries, may adversely affect the Brazilian economy, may make it more difficult or expensive for us to obtain additional debt financing and, therefore, may affect the market price of the preferred shares and the ADSs.

Securities of Brazilian issuers have been, to varying degrees, influenced by economic and market conditions in other countries, particularly emerging market countries. Although economic conditions differ in each country, investors' reactions to developments in one country may affect the securities of issuers in other countries, including Brazil. Since the fourth quarter of 1997, the international financial markets have experienced significant volatility, and a large number of market indices, including those in Brazil, have declined significantly. For example, the political crisis in Venezuela, the recession in Argentina, the economic difficulties of Ecuador and Turkey, the Asian economic crisis, and the 1998 Russian debt moratorium and devaluation of the Russian currency triggered market volatility in Brazil's and other emerging market countries' securities markets. See Item 5A. Operating Results Brazilian Economic Environment for a discussion of recent events. In the third week of September 2001, upon the reopening of the New York Stock Exchange after its closure for four business days following the September 11th terrorist attacks in the United States, the Dow Jones Industrial Average experienced its largest single-week decline since the 1930s. In the same period, the Ibovespa, the index of the São Paulo Stock Exchange, experienced a decline of 18.1%.

These events discouraged investment worldwide, including international investment in Brazil, and, more directly, has caused a decline in the market for our preferred shares and ADSs. In addition, the continuation of the Argentine recession and the recent devaluation of the peso could affect the Brazilian economy, as Argentina is one of South America's largest economies. Further negative developments in the international financial markets, especially in South America, may adversely affect our financial condition and our ability to obtain debt financing on acceptable terms or at all. We cannot assure you that the Brazilian securities markets will not continue to be affected negatively by events elsewhere, especially in Argentina, Venezuela and other emerging markets, or that these events will not adversely affect the market price of our preferred shares and ADSs.

Risks Relating to the Preferred Shares and the ADSs

Exchange controls and restrictions on remittances abroad may adversely affect the holders of our ADSs.

The Brazilian government may impose temporary restrictions on the conversion of Brazilian currency into foreign currencies and on the remittance to foreign investors of proceeds from their investments in Brazil. The Brazilian government imposed remittance restrictions for a number of months in 1989 and early 1990. These restrictions would hinder or prevent the conversion of dividends, distributions or the proceeds from any sale of preferred shares, as the case may be, from *reais* into U.S. dollars and the remittance of the U.S. dollars abroad. We cannot assure you that the Brazilian government will not take similar measures in the future. Holders of our ADSs could be adversely affected by delays in, or refusals to grant, any required governmental approval for conversion of *real* payments and remittances abroad in respect of the preferred shares underlying the ADSs. In such a case, the depository for the ADSs will hold the *reais* it cannot convert for the account of the ADR holders who have not been paid. The depository will not invest the *reais* and will not be liable for interest on those amounts.

If holders of ADSs exchange the ADSs for preferred shares, they risk losing the ability to remit foreign currency abroad and Brazilian tax advantages.

The Brazilian custodian for the preferred shares has obtained an electronic certificate of registration from the Central Bank permitting it to remit foreign currency abroad for payments of dividends and other distributions relating to the preferred shares or upon the disposition of the preferred shares. If holders of ADSs decide to exchange their ADSs for the underlying preferred shares, they will be entitled to continue to rely on the custodian's electronic certificate of registration for five business days from the date of exchange. Thereafter, such holders of ADSs may not be able to obtain and remit foreign currency abroad upon the disposition of, or distributions relating to, the preferred shares unless they obtain their own electronic certificate of registration or register their investment in the preferred shares pursuant to Resolution No. 2,689, which entitles certain foreign investors to buy and sell securities on the São Paulo Stock Exchange. Holders who do not qualify under Resolution No. 2,689 will generally be subject to less favorable tax treatment on gains with respect to the preferred shares. If holders of ADSs attempt to obtain their own electronic certificate of registration, they may incur expenses or suffer delays in the application process, which could delay their ability to receive dividends or distributions relating to the preferred shares or the return of their capital in a timely manner. We cannot assure you that the custodian's electronic certificate of registration or any certificate of foreign capital registration obtained by a holder of ADSs will not be affected by future legislative or other regulatory changes, or that additional restrictions applicable to such holder, the disposition of the underlying preferred shares or the repatriation of the proceeds from disposition will not be imposed in the future.

The relative volatility and illiquidity of the Brazilian securities markets may substantially limit the ability of holders of our preferred shares or ADSs to sell the preferred shares underlying the ADSs at the price and time they desire.

Investing in securities, such as the preferred shares or the ADSs, of issuers from emerging market countries, including Brazil, involves greater risk than investing in securities of issuers from more developed countries, and such investments are generally considered speculative in nature.

The Brazilian securities markets are substantially smaller, less liquid, more concentrated and more volatile than major securities markets in the United States and other jurisdictions, and are not as highly regulated or supervised as some of these other markets. The relatively small market capitalization and illiquidity of the Brazilian equity markets may substantially limit the ability of holders of our preferred shares or ADSs to sell the preferred shares underlying the ADSs at the price and time desired. See Item 9C. Markets Trading on the São Paulo Stock Exchange.

Because we are subject to different corporate rules and regulations as a Brazilian company, holders of our ADSs have fewer and less well-defined shareholders' rights.

Our corporate affairs are governed by our bylaws and the Brazilian Corporate Law, which differ from the legal principles that would apply if we were incorporated in a jurisdiction in the United States, such as Delaware or New York, or in other jurisdictions outside Brazil. As a result, the holders of the ADSs or the holders of our preferred shares may have fewer and less well-defined rights under Brazilian Corporate Law with which to protect their interests against actions by our board of directors and our principal shareholders than under the laws of those jurisdictions outside Brazil.

Although the Brazilian Corporate Law imposes restrictions on insider trading and price manipulation, the Brazilian securities markets are not as highly regulated and supervised as the U.S. securities markets or markets in other jurisdictions. In addition, rules and policies against self-dealing and regarding the preservation of minority shareholder interests may be less well-defined and enforced in Brazil than in the United States, putting holders of the preferred shares and ADSs at a potential disadvantage. Corporate disclosures may be less complete or informative than what may be expected of a U.S. public company. Specifically, among other differences when compared to, for example, Delaware general corporation law, Brazilian Corporate Law and practice has less detailed and well-established rules and judicial precedents relating to the review of management decisions against duty of care and duty of loyalty standards in the context of corporate restructurings, transactions with related parties and sale-of-business transactions. In addition, the Brazilian Corporate Law provides that shareholders must hold 5% of the outstanding share capital of a corporation to have standing to bring shareholders' derivative suits, and shareholders ordinarily do not have standing to bring a class action.

Also, in accordance with Brazilian Corporate Law, holders of our preferred shares, and therefore our ADSs, are not entitled to vote at meetings of our shareholders except in limited circumstances. See Item 10B. Memorandum and Articles of Incorporation Description of Capital Stock Voting Rights of the Preferred Shares.

Changes to the Brazilian Corporate Law were approved by the Brazilian Congress and became effective as of March 2002. Such changes may adversely affect the rights of holders of our ADSs. See Item 10B. Memorandum and Articles of Association Changes to the Brazilian Corporate Law.

The Brazilian government has veto power over major corporate actions; our controlling shareholders act in concert to control Embraer.

The Brazilian government holds one special class of our common stock, called a "golden share," which carries veto power over, among other things, change of control, change of corporate purpose and creation and alteration of defense programs (whether or not the Brazilian government participates in such programs). In addition, under the terms of a shareholders' agreement, our controlling shareholders Cia. Bozano, Caixa de Previdência dos Funcionários do Banco do Brasil PREVI, also known as PREVI, and Fundação SISTEL de Seguridade Social, also known as SISTEL, act in concert to vote 60% of the outstanding shares of our common stock, allowing them to elect a majority of the members of our board of directors and to determine the outcome of any actions requiring shareholder approval, including corporate reorganizations and the timing and payment of future dividends.

The sale of a substantial number of preferred shares, or the belief that this may occur, could decrease the trading price of the preferred shares and the ADSs; holders of our preferred shares and/or ADSs may not be able to sell their securities at or above the price they paid for them.

Sales of a substantial number of preferred shares, or the belief that this may occur, could decrease the trading price of our preferred shares and our ADSs. As of December 31, 2002, we had 470,429,907 preferred shares outstanding. Of this amount, holders of exchangeable notes that were issued in June 2001 by Banco Nacional de Desenvolvimento Econômico e Social BNDES, the Brazilian National and Social Development Bank, also known as BNDES, have the right to acquire, at any time prior to the maturity of the notes, an aggregate of 7,279,200 ADSs, representing 29,116,800 preferred shares currently owned by BNDES Participações S.A. BNDESPAR, also known as BNDESPAR, a wholly owned subsidiary of BNDES, subject to adjustment. As a consequence of the issuance of preferred shares or sales by existing shareholders, the market price of the preferred shares and, by

extension, the ADSs may decrease significantly. As a result, the holders of our ADSs and/or preferred shares may not be able to sell their securities at or above the price they paid for them.

Our share price may be affected by potential dilution of our preferred shares and the ADSs.

The issuance of preferred shares pursuant to our stock option plan could substantially dilute the preferred shares. Under the terms of our stock plan, we were authorized to grant options to purchase up to 25,000,000 preferred shares over the five-year period from the date of the first grant of options pursuant to the plan. As of the end of this five-year period, we had granted options for an aggregate of 19,665,000 preferred shares. The options granted to each employee generally vest as follows: 30% after three years from the date granted, an additional 30% after four years and the remaining 40% after five years. Employees may exercise their options for up to seven years from the date they are granted. As of December 31, 2002, options representing 7,196,313 preferred shares have already been exercised and options representing 4,757,218 preferred shares are exercisable in 2003.

Holders of our ADSs might be unable to exercise preemptive rights with respect to the preferred shares.

Holders of our ADSs may not be able to exercise the preemptive rights relating to the preferred shares underlying their ADSs unless a registration statement under the Securities Act is effective with respect to those rights or an exemption from the registration requirements of the Securities Act is available. We are not obligated to file a registration statement with respect to the shares or other securities relating to these preemptive rights and we cannot assure holders of our ADSs that we will file any such registration statement. Unless we file a registration statement or an exemption from registration applies, holders of our ADSs may receive only the net proceeds from the sale of their preemptive rights by the depositary or, if the preemptive rights cannot be sold, the rights will be allowed to lapse.

ITEM 4. INFORMATION ON THE COMPANY

4A. History and Development of the Company

General

Embraer-Empresa Brasileira de Aeronáutica S.A. is a joint stock company duly incorporated under the laws of Brazil with an indefinite term of duration. Originally formed in 1969 by the Brazilian government, we were privatized by the Brazilian government in 1994. In connection with our privatization, we were transformed into a publicly held corporation and we operate under the Brazilian Corporate Law. Our principal executive offices are located at Avenida Brigadeiro Faria Lima, 2170, 12227-901 São José dos Campos, São Paulo, Brazil. Our telephone number is 55-12-3927-1216. Our agent for service of process in the United States is our subsidiary, Embraer Aircraft Holding, Inc., with offices at 276 S.W. 34th Street, Ft. Lauderdale, Florida 33315.

We have grown from a government-controlled company established to develop and produce aircraft for the Brazilian Air Force into a public company that produces aircraft for commercial, corporate and defense purposes. Through our evolution, we have obtained, developed and enhanced our engineering and technological capabilities through our own development of products for the Brazilian Air Force and through joint product development with foreign companies on specific projects. We have applied these capabilities that we gained from our defense business to develop our regional aircraft business.

Our first major regional aircraft was the Bandeirante, a 19-passenger twin engine non-pressurized turboprop aircraft initially designed to service the transport needs of the Brazilian Air Force. The Bandeirante was followed by the development of the EMB 120 Brasília, a high performance, pressurized turboprop commercial aircraft seating up to 30 passengers and designed to serve the longer routes and higher passenger traffic of the growing regional aircraft market. Drawing upon the design of the EMB 120 Brasília and the jet technology acquired in our development of the AM-X, a defense aircraft for the Brazilian Air Force, we developed the ERJ 145 regional jet family, our first jet product for commercial use. We are expanding our jet product line with the development of the EMBRAER 170/190 jet family, designed to serve the aircraft market's trend towards larger, higher volume and longer range jets. We are also marketing and selling the Legacy, a line of corporate jets based on our ERJ 135

regional jet, with several improvements including longer range. For the Defense market, we also offer a line of Intelligence, Surveillance and Reconnaissance aircraft based on the ERJ 145 regional jet.

Strategic Alliance and Growth Opportunities

Strategic Alliance with European Aerospace and Defense Group

On November 5, 1999, a group consisting of Aerospatiale Matra, currently known as European Aeronautic, Defense and Space Company N.V., or EADS, Dassault Aviation, Thomson-CSF, currently referred to by its trade name Thales, and Société Nationale d'Étude et de Construction de Moteurs d'Aviation, or SNECMA, which we refer to collectively as the European Aerospace and Defense Group, purchased as a single investor 20% of the outstanding common stock of Embraer from our existing common shareholders, a majority of which was from our controlling shareholders. We believe that this alliance will continue to assist us in the development of new defense products and enable us to expand our defense markets. For example, we integrated Thales mission systems and electronic equipment in some of our EMB 145 AEW&C/RS/MP aircraft.

Joint Ventures and Acquisitions

In 2000, we entered into a joint venture with Liebherr International AG to develop and manufacture landing gear and high precision hydraulic equipment and provide related services for Embraer and other clients around the world. In connection with this joint venture, we formed a new subsidiary, ELEB - Embraer Liebherr Equipamentos do Brasil S.A.

In March 2002, we acquired the operating assets of Celsius Aerotech Inc. in Nashville, Tennessee from Reliance Aerotech Inc. in order to provide full service maintenance and repair services for our regional and corporate aircraft in the United States.

In December 2002, we entered into a joint venture with Harbin Aircraft Industry (Group) Co., Ltd. and Hafai Aviation Industry Co., Ltd., subsidiaries of China Aviation Industry Corp. II, or AVIC II, to provide for the manufacture, sale and after-sale support of the ERJ 145 regional jet family. We own 51% of the equity of the joint venture company, Harbin Embraer Aircraft Industry Company Ltd.

Research and Development Costs and Capital Expenditures

Research and development costs, including the development of the new EMBRAER 170/190 jet family, were US\$69.6 million in 2000, US\$99.6 million in 2001 and US\$158.5 million in 2002. Research and development costs as a percentage of our net sales were 2.5% in 2000, 3.4% in 2001 and 6.3% in 2002. The increases in research and development costs as a percentage of our net sales in 2001 and 2002 reflect principally the costs related to the EMBRAER 170/190 jet family.

Our investments in property, plant and equipment totaled US\$114.2 million in 2000, US\$143.8 million in 2001 and US\$127.7 million in 2002. The investments in 2001 and 2002 related to construction of facilities, improvements to our plant and production facilities and modifications for the production of new aircraft models.

We expect our future research and development costs to increase as a result of the continued development of the EMBRAER 170/190 jet family. In 2003, we expect research and development costs to total approximately US\$167.0 million and we expect investments in property, plant and equipment to total approximately US\$58.0 million, which will primarily be related to improvements to and expansion of our facilities, in particular for the production of the EMBRAER 170/190 jet family, as well as our defense aircraft and corporate jets.

4B. Business Overview

We are one of the leading manufacturers of commercial aircraft in the world, based on 2002 net sales of commercial aircraft, with a global customer base. We focus primarily on manufacturing regional aircraft, which accounted for 83.6% of our net sales in 2002. We are the leading supplier of defense aircraft for the Brazilian Air

Force based on number of aircraft sold, and we have also sold aircraft to military forces in Europe and Latin America. In addition, we have developed a new line of corporate jets based on one of our regional jets. For the year ended December 31, 2002, we generated net sales of US\$2,525.8 million, of which approximately 97.7% was U.S. dollar-denominated. At June 30, 2003, we had a total backlog in orders of US\$10.3 billion, including 450 regional jets.

Our Strengths

We believe that our primary strengths are:

Leading Regional Jet Manufacturer with a Global Customer Base. We are a leading manufacturer of regional and mid-capacity jets with a strong global customer base. We have sold our regional jets to 31 customers in 20 countries. Our customers include some of the largest regional airlines in the world.

Aircraft Design; Cost and Operating Efficiency. We produce aircraft to provide our customers with reduced operating, maintenance and training costs due to the similarity and efficiency in design and the commonality of parts among jets within a family. These similarities enable us to significantly reduce our design, development and production costs and pass these savings along to our customers in our sales price. These similarities also reduce the development time of our aircraft. The flexibility of our regional jet families also enables us to cost-effectively develop new aircraft to meet specific customer needs and to target new markets.

Strategic Risk-Sharing Partners. With our regional and mid-capacity jet families, we developed strategic relationships with key risk-sharing partners. These risk-sharing partners develop and manufacture significant portions of the systems and components of our aircraft and contributed their own funds to research and develop these systems and components, thereby reducing our development costs. These risk-sharing partners also funded a portion of our development costs through direct contributions of cash or materials. We believe that these strategic relationships enable us to lower our development costs and risks, improve our operating efficiency, enhance the quality of our products and reduce the number of our suppliers.

Benefits of Funded Development of Defense Technology. Research and development costs related to defense aircraft historically have been funded in large part by the Brazilian government. We are able to apply the technological developments we acquire from our defense technology to applications in our commercial business. For example, we developed our regional jet family based on the AM-X program developed for the Brazilian Air Force. In addition, we sell proven defense products developed for the Brazilian Air Force to other military forces.

Flexibility of Production to Meet Market Demands. We believe the flexibility of our production processes and our operating structure, including our risk-sharing partnerships that are designed to minimize fixed costs, allow us to increase or decrease our production in response to market demand without significantly impacting our margins.

Experienced and Highly Skilled Workforce. Our employees are experienced and highly skilled. Over 23% of our workforce is comprised of engineers. Due to the high level of knowledge and skill possessed by our employees, we are able to efficiently pursue new programs and provide our customers with additional technical expertise and guidance.

Business Strategies

Aggressively Market Our Mid-capacity Jet Family. We are aggressively marketing our mid-capacity platform, the EMBRAER 170/190 jet family. We believe a significant market opportunity exists for the EMBRAER 170/190 jet family with regional airlines that are expanding their fleet, increasing their penetration into higher density markets and adding longer routes, and also with other airlines that are optimizing their fleet in order to adjust capacity to meet demand in less dense routes. Additionally, we believe that our new mid-capacity jet family will provide us with significant opportunities to increase our competitiveness by offering our customers a full range of regional aircraft.

Develop Our Strategic Alliance with European Aerospace and Defense Group. We believe our strategic alliance with the European Aerospace and Defense Group will enhance our defense business. We intend to enhance our technological capabilities and increase our production and marketing of innovative defense products. We also intend to increase our international marketing presence for our defense products through joint marketing efforts with members of the European Aerospace and Defense Group.

Increase Focus on Customer Support. Providing high quality customer support is critical to our ability to maintain long-term relationships with our customers. As the number of our aircraft in operation continues to grow, we have increased our commitment to providing our customers with an appropriate level of after-sale support, including technical assistance, pilot and maintenance training and spare parts, as demonstrated by our 2002 acquisition of a Nashville, Tennessee aircraft service center. We intend to continue to focus on providing our customers with high quality customer support.

Expand Risk-Sharing Arrangements. We intend to maintain or expand the role of risk-sharing partners in the production process for our aircraft in order to reduce production costs and streamline the management of our suppliers. Having fewer suppliers enables us to minimize our production costs while allocating additional risk for the production of integrated systems to our risk-sharing partners.

Diversify Revenues. We intend to diversify our revenues through our corporate jet segment and our defense segment.

Increase Penetration into the Defense Market. We plan to develop and market additional defense products and thereby increase sales in this segment of our business. We intend to increase our participation in the international defense market by actively marketing our existing products initially developed for the Brazilian Air Force, including the EMB 145 AEW&C, the EMB 145 RS, the EMB 145 MP and the Super Tucano (ALX).

Cost-Effectively Develop a Line of Corporate Jets. We have developed the Legacy, a new line of corporate jets based on the ERJ 135 regional jet, to provide to businesses, including fractional ownership companies, a cost-effective alternative to commercial airline travel. In developing the Legacy, we used the same design and risk-sharing arrangements of our ERJ 135 regional jet. As a result, we were able to develop the Legacy without the substantial financial investment normally associated with a new product launch.

Pursue Strategic Growth Opportunities. We intend to pursue strategic growth opportunities, which may include joint ventures, acquisitions and other strategic transactions. For example, we intend to expand our presence in China through our joint venture with AVIC II. We believe that the market for regional aircraft in China is strong and currently underserved. We believe this market will create incremental growth for our future revenues.

Regional Aircraft Business

We design, develop and manufacture a range of regional aircraft. Our regional aircraft business is our primary business, accounting for 83.6% of our net sales for the year ended December 31, 2002.

Products

We developed the ERJ 145, a 50-passenger twin turboprop-powered regional jet, introduced in 1996, to address the growing demand among regional airlines for medium-range jet-powered aircraft. After less than two years of development, the ERJ 135, a 37-passenger regional jet based on the ERJ 145, was introduced in July 1999. In addition, we developed the 44-seat ERJ 140 as part of the ERJ 145 regional jet family, which we began delivering in the second half of 2001. We believe that the ERJ 145 regional jet family provides the comfort, range and speed of a jet at costs comparable to turboprop aircraft. We are currently developing our 70-108 seat platform, the EMBRAER 170/190 jet family, to serve the trend in the regional aircraft market toward larger, faster and longer range jets and to further diversify our strength in the jet market. We continue to analyze new aircraft demand in the jet market to determine potentially successful modifications to aircraft we already produce.

ERJ 145 Regional Jet Family

The ERJ 145 is a twin turbofan-powered regional jet accommodating up to 50 passengers. This jet was developed in response to the increasing demand from the regional airline industry for an aircraft that offered more speed, comfort and capacity than a turboprop. The ERJ 145 was certified by the Brazilian aviation authority in November 1996, the FAA in December 1996, the European aviation authority in May 1997 and the Australian aviation authority in June 1998. We began delivering the ERJ 145 in December 1996.

The development of the ERJ 145 aircraft was partially based on the EMB 120 Brasília and has approximately 30% commonality in terms of parts and components with that aircraft, including the nose section and cabin. The ERJ 145 has a maximum cruising speed of Mach .78, or 450 knots, and a maximum fully loaded range of 1,060 nautical miles in its standard version. The ERJ 145 is equipped with engines built by Rolls-Royce Allison. These engines are designed to operate 10,000 flight hours between major overhauls and operate at a low fuel cost. In addition, the ERJ 145 is equipped with sophisticated flight instruments, such as engine-indication instruments, crew-alert systems and digital flight control systems, produced by Honeywell.

The ERJ 145 is also available in a long-range, or LR, version, and, in response to customer requests, we have developed an extra-long-range, or XR, version of the aircraft. The ERJ 145 LR features a larger fuel tank, more powerful engines and greater range than the standard version. The ERJ 145 LR, which was certified by the Brazilian aviation authority, the FAA and the European aviation authority in 1998, and by the Chinese aviation authority in November 2000, uses engines that deliver 15% more thrust, allowing the fully loaded aircraft to operate on routes of up to 1,550 nautical miles. The ERJ 145 XR features a new and updated turbofan engine, increased capacity fuel tanks and winglets. The ERJ 145 XR, which was certified by the Brazilian aviation authority in August 2002 and by the FAA in October 2002, offers reduced fuel consumption, a maximum fully loaded range of 2,000 nautical miles and enhanced operational capabilities for hot weather and at high altitudes. Deliveries of the ERJ 145 LR began in February 1998, and deliveries of the ERJ 145 XR began in October 2002.

The ERJ 135 is a 37-seat regional jet based on the same design as the ERJ 145 and is manufactured on the same production line. The ERJ 135 has approximately 96% commonality in terms of parts and components with the ERJ 145, resulting in reduced spare parts requirements and permitting the utilization of the same ground support equipment for customers that use both aircraft. The ERJ 145 regional jet family also allows for standardized pilot certification and maintenance procedures. The ERJ 135 was certified by the Brazilian aviation authority in June 1999, by the FAA in July 1999 and by the European aviation authority in October 1999. Deliveries of the ERJ 135 began in July 1999.

The ERJ 135 has a maximum operating speed of Mach .78, or 450 knots, and a maximum fully loaded range of 1,330 nautical miles in its standard version. The ERJ 135 uses the same engines, sophisticated flight instruments, digital flight control systems and body design as the ERJ 145. The ERJ 135's fuselage is 11.6 feet shorter than the ERJ 145's. The ERJ 135 is also available in a long-range, or LR, version, which features a larger fuel tank, more powerful engines and significantly greater maximum fully loaded range (1,700 nautical miles) than the standard version. The LR version received certification simultaneously with the standard version and began deliveries in August 1999.

We developed the ERJ 140 in response to customer requests. The ERJ 140 is a 44-seat regional jet based on the same design as the ERJ 135 and is manufactured on the same production line as the ERJ 145 and ERJ 135. The ERJ 140 has approximately 96% commonality with the ERJ 145 and ERJ 135, providing our customers with significant maintenance and operational benefits. The ERJ 140 was certified by the Brazilian aviation authority in June 2001 and by the FAA in July 2001. The ERJ 140 has a maximum fully loaded range of 1,230 nautical miles in its standard version. The ERJ 140 is available in a long-range, or LR, version, which features a larger fuel tank, more powerful engines and significantly greater maximum fully loaded range (1,630 nautical miles) than the standard version. We began delivering the ERJ 140 in July 2001.

EMBRAER 170/190 Jet Family

The EMBRAER 170/190 jet family provides our customers with a choice of four aircraft in the mid-capacity passenger range. The EMBRAER 170 will be a 70-passenger jet, and the EMBRAER 175 will be a 78-passenger jet, while the EMBRAER 190 series will include the 98-passenger EMBRAER 190 and the 108-passenger EMBRAER 195.

We expect to receive certification of the EMBRAER 170 in 2003, the EMBRAER 175 in 2004, the EMBRAER 190 in 2005 and the EMBRAER 195 in 2006. The EMBRAER 170 made its maiden flight on February 19, 2002 and, as of June 2003, has flown more than 2000 hours as part of its flight test program. We have completed the joint design definition phase and are currently producing the first prototypes of the EMBRAER 175 and EMBRAER 195. The EMBRAER 175 made its maiden flight on June 14, 2003. We are currently in the preliminary development phase of the EMBRAER 190.

We designed the EMBRAER 170/190 jet family to maximize the benefits of commonality, with aircraft in the family sharing approximately 89% of the same components. The high level of commonality in this new jet family lowered our development costs and shortened our development period. We anticipate that this commonality will lead to significant savings to our customers in the form of easier training, less expensive parts and maintenance and lower operational costs. Due to differences in size and weight, the EMBRAER 170/190 jet family will not share the same wing design. This new regional jet family will have engines fixed under its main wings a design intended to enhance power, improve fuel economy and minimize turnaround times. All of the aircraft models will be powered by engines manufactured by General Electric and will contain state-of-the-art avionics manufactured by Honeywell.

The EMBRAER 170/190 jet family's principal features are:

Performance. All four jets in the EMBRAER 170/190 jet family will have a maximum cruising speed of Mach .8, or 470 knots. The EMBRAER 170 and the EMBRAER 175 will have maximum fully loaded ranges of 1,800 and 1,600 nautical miles, respectively, and will be available in long-range, or LR, versions, with maximum fully loaded ranges of 2,100 and 1,900 nautical miles, respectively. The EMBRAER 190 and EMBRAER 195 will have maximum fully loaded ranges of 1,800 and 1,400 nautical miles, respectively, and will also be available in LR versions with maximum fully loaded ranges of 2,300 and 1,800 nautical miles, respectively. The LR versions of all four jets in the EMBRAER 170/190 jet family will feature larger fuel tanks and more powerful engines than the standard versions of these aircraft.

Ground servicing. The under-wing engine design and the existence of four doors, two in the front and two in the back, provide for enhanced accessibility and efficiency of ground services.

Cabin and cargo space. We have enhanced passenger safety and comfort in the EMBRAER 170/190 jet family. The aircraft's double-bubble design will enable a four-abreast cabin, a wide aisle, greater interior space and headroom and a larger baggage floor compartment than the existing mid-capacity jets of our competitors, as well as those mid-capacity jets that are in the development stage.

EMB 120 Brasília

The EMB 120 Brasília is a pressurized twin wing-mounted turboprop aircraft that accommodates up to 30 passengers. The EMB 120 Brasília was developed in response to the regional aircraft industry's demand for a high-speed and fuel-efficient 30-seat regional aircraft. The EMB 120 Brasília was certified by the FAA in May 1985 and by the Brazilian aviation authority in July 1985. Since its introduction in 1985 and through December 31, 2002, we have delivered 347 EMB 120 Brasília's for the regional market and five EMB 120 Brasília's for the defense market. We currently manufacture the EMB 120 Brasília only upon customer request.

Customers

While we have focused our efforts on the U.S. and European markets to date, we have achieved a diverse, global customer base for our aircraft, principally in the regional jet market. Our major customers of regional aircraft include some of the largest regional airlines in the world. As of June 30, 2003, our largest customers are ExpressJet, American Eagle, JetBlue Airways, US Airways, Wexford and SWISS. For a discussion of these significant customer relationships, see Item 3D. Risk Factors Risks Relating to Embraer We depend on a small number of key customers and key suppliers, the loss of any of which could harm our business.

We generally sell our regional aircraft pursuant to contracts with our customers on a fixed-price basis, adjusted by an escalation formula that reflects, in part, inflation in the United States. These contracts generally include an option for our customers to purchase additional aircraft for a fixed option price, subject to adjustment based on the same escalation formula. In addition, our contracts provide for after-sales spare parts and services, as well as warranties of our aircraft and spare parts. Other provisions for specific aircraft performance and design requirements are negotiated with our customers. Finally, some of our contracts contain cancellation provisions, repurchase and trade-in options and financial and residual value guarantees. See Item 3D. Risk Factors Risks Relating to Embraer Our aircraft sales are subject to cancellation provisions, repurchase and trade-in options and financial and residual value guarantees that may reduce our cash flow or require us to make significant cash disbursements in the future for a more detailed discussion of these provisions.

Sales and Marketing

Our current marketing strategy is based upon our assessment of the worldwide regional airline market and our assessment of the current and future needs of our customers. We actively market our aircraft to regional airlines and regional affiliates of major airlines through our regional offices in the United States, Europe and Asia. Our success depends to a significant extent on our ability to discern our customers' needs, including needs for customer service and product support, and to fill those needs in a timely and efficient manner while maintaining the high quality of our products. Our market and airline analysts focus on the long-term vision of the market, competitive analysis, product enhancement planning and airline analysis. In terms of direct marketing to our customers, we rely heavily on addressing the media, as well as participating in air shows and other cost-effective events that enhance customer awareness and brand recognition. We have regional sales offices in Le Bourget, France; Melbourne, Australia; Ft. Lauderdale, Florida, USA; Beijing, China; and Singapore. We will sell our ERJ 145 regional jet family in the Chinese market exclusively through our joint venture in China.

Production, New Orders and Options

Prior to starting production or development of a new project, we secure letters of intent representing future orders for a significant number of aircraft. We typically begin taking orders and building backlog two years before we begin producing a new aircraft model, aiming to receive a significant number of orders before we deliver the initial aircraft. Once an order is taken, we reserve a place for that order on the production line, ensuring that we will maintain production sufficient to meet demand. Once a place is reserved on the production line, we are able to give customers delivery dates for their orders.

We include an order in backlog once we have received a firm commitment, represented by a signed contract. Our backlog excludes options and letters of intent for which definitive contracts have not been executed. For the sales of our regional aircraft, we customarily receive a deposit upon signing of the purchase agreement and progress payments in the amount of 5% of the sales price of the aircraft 18 months before scheduled delivery, another 5% twelve months before scheduled delivery and another 5% six months before scheduled delivery. For the EMBRAER 170/190 jet family, we receive an additional 5% progress payment 24 months before scheduled delivery. We typically receive the remaining amount of the sales price upon delivery of the aircraft. The deposits and the progress payments are generally non-refundable if orders are cancelled.

With respect to options to purchase our aircraft, we customarily receive US\$100,000 for each aircraft in the ERJ 145 regional jet family and US\$200,000 for each aircraft in the EMBRAER 170/190 jet family. Our options generally provide our customers the right to purchase an aircraft in the future at a fixed price and on a specified delivery date, subject to escalation provisions, under a purchase contract. Once a customer decides to exercise an

option, we account for it as a firm order. On occasion, we have extended the exercise date for our options and renegotiated the delivery schedule of firm orders. On occasion, we have allowed customers to convert their firm orders or options for one aircraft into firm orders or options for another aircraft within the same regional jet family.

Competition

We generally face competition from major manufacturers in the international regional aircraft market. Each category of our products faces competition of a different nature and generally from different companies. Some of our competitors have greater financial, marketing and other resources than we do. In the 30-60 seat category, the main competitor of the ERJ 135 and the EMB 120 Brasília aircraft is the De Havilland DHC-8-200, a turboprop aircraft. The main competitors of the ERJ 145 regional jet family are:

the CRJ-100/200/440, manufactured by Bombardier;

the 328Jet previously developed and manufactured by Fairchild Dornier and now manufactured to order by Avcraft Aviation LLC;

the ATR-42, manufactured by ATR G.I.E., a joint project of Italy's Alenia Aerospaziale and EADS; and

the DHC-8-300, manufactured by De Havilland.

Only Bombardier's CRJ-100/200/440 are jet aircraft. Fairchild Dornier filed for bankruptcy protection in April 2002, and the 328Jet is currently marketed and manufactured to order by Avcraft Aviation LLC. Given the success of our regional jet family and the significant barriers to entry into the market, due principally to the high development costs of a new model and the extensive and time-consuming development cycle of a new jet, we believe that we are well positioned to increase our market share for the ERJ 145 regional jet family.

In the 61-90 and 91-120 seat categories, we face our strongest competition. Currently, there are three aircraft in the segment, De Havilland's DHC-8-400, a 72-seat turboprop, ATR's ATR72, a 72-seat turboprop, and Bombardier's CRJ-700, a 70-seat regional jet, which was first delivered in January 2001. Bombardier has also launched the larger CRJ-900 aircraft, which seats 85 passengers and began deliveries in January 2003, before the expected delivery of our EMBRAER 175. In the larger end of the category, Boeing has launched the 717-200, a 106-112 seat jet. Furthermore, Airbus developed a 100+ seat jet, the A318, which was certified by the Joint Aviation Authority of Europe, or JAA, in May 2003. The key competitive factors in the markets in which we participate include design and technological strength, aircraft operational costs, price of aircraft, including financing costs, customer service and manufacturing efficiency. We believe that we will be able to compete favorably with our competitors on the basis of our global customer base, aircraft performance, low operating costs, product development experience, market acceptance, cabin design and aircraft price.

Defense Business

We design, develop, integrate and manufacture a wide range of defense products, principally transport, training, light attack and surveillance aircraft. We are the leading supplier of defense aircraft to the Brazilian Air Force based on number of aircraft sold. We also have sold defense aircraft to military forces of 16 other countries in Europe and Latin America, including the United Kingdom, France, Greece and Mexico. At December 31, 2002, we had sold 519 defense aircraft to the Brazilian government and 525 defense aircraft to other military forces. Our defense business accounted for 5.0% of our net sales for the year ended December 31, 2002.

Products

Tucano Family; AL-X

The Tucano is a single engine turboprop aircraft used for pilot training and armed reconnaissance missions. Although no longer manufactured, over 650 EMB 312 Tucanos are in operation in 15 air forces worldwide,

including those of Brazil, the United Kingdom, France, Argentina, Egypt, Colombia, Paraguay, Peru and Venezuela. We are developing the Super Tucano, or the AL-X (*Aeronave Leve de Ataque*, or Light Attack Aircraft). The Super Tucano offers an engine with twice the power of the Tucano's standard engine, fighter standard avionics, ejection seats, an on-board oxygen-generating system and enhanced range and external loads capability. We are currently marketing the Super Tucano. The AL-X is being developed under a contract with the Brazilian Air Force, with FINEP providing US\$21.7 million in research and development debt financing, of which US\$4.4 million was outstanding as of December 31, 2002. The AL-X has sophisticated navigation and attack systems, night operations capability and the ability to operate under severe weather conditions. We have received firm orders for 76 of these aircraft and an additional 23 options from the Brazilian Air Force. One prototype of the AL-X has been flying since 1995, and the maiden flight of the first pre-production aircraft occurred in May 1999. We expect first delivery to be made by the end of 2003. These aircraft are expected to be used for advanced pilot training and for defense operations in the Amazon region of Brazil in connection with the Brazilian government's SIVAM (*Sistema de Vigilância da Amazônia*, or System for the Surveillance of the Amazon) program.

EMB 145 AEW&C; EMB 145 RS; EMB 145 MP

We have configured a special version of the ERJ 145 with an advanced early warning and control system to create the EMB 145 AEW&C, with ground remote sensing capability to create the EMB 145 RS, and with marine remote sensing capability to create the EMB 145 MP. The EMB 145 AEW&C's advanced phased-array radar and mission system, developed by Ericsson, is capable of conducting surveillance and providing air traffic control in support of aviation authorities. The EMB 145 RS is designed to carry out ground surveillance and environmental protection activities using advanced synthetic aperture radar, capable of providing day/night and all weather images of the ground over large areas, with multi-spectral sensors developed by subcontractors in the United States. The EMB 145 MP is designed to carry out maritime patrol and anti-submarine warfare missions, using maritime and ground surveillance radar, electro-optical sensors, and communications and other surveillance equipment developed by Ericsson and Thales. We, Ericsson and Thales are jointly marketing these aircraft worldwide. At December 31, 2002, the Brazilian government had ordered a total of eight EMB 145 AEW&C/RS aircraft to conduct surveillance and monitor ground activities in the Amazon region, and, as of December 31, 2002, we had delivered four EMB 145 AEW&Cs and one EMB 145 RS. In October 1999, the Greek government, represented by the Hellenic Air Force, ordered four EMB 145 AEW&C aircraft that will be used in the Greek government's aerospace early warning and control system. Under the same contract, the Greek government purchased one ERJ 135 aircraft for special transportation and support needs. In addition, in February 2001, the Mexican government ordered one EMB 145 AEW&C aircraft and two EMB 145 MP aircraft.

AM-X; AMX-T

The AM-X is a subsonic ground attack and close air support aircraft developed under an international cooperation agreement with Alenia Un Azienda Finmeccanica S.p.A. and AerMacchi Aeronautica Macchi S.p.A. and sponsored by the Brazilian and Italian governments. Under the agreement, each of the parties is responsible for key systems of the aircraft. The AM-X is assembled in both Brazil and Italy. Each of Embraer and the Italian partners supplies the other with different key components and systems of the aircraft. In addition, each of Embraer and the Italian partners is free to market the aircraft independently and receives 100% of the proceeds of its sales. Approximately 170 AM-X aircraft are currently in operation in the air forces of Brazil and Italy, of which 55 were sold by us.

We have also developed, with the participation of Alenia and AerMacchi, the AMX-T, an enhanced version of the AM-X, currently being offered internationally. The AMX-T program operates under the same principles as the AM-X program, with the exception that Alenia's role is greater than AerMacchi's, which participates only as a subcontractor. In September 1999, we won the bid for a contract for the sale of a number of AMX-Ts to the Venezuelan government.

Other Projects and Activities

In December 2000, we were selected by the Brazilian government to perform a structural and electronics upgrade of the Brazilian Air Force's F-5 fighter jets. As the prime contractor, we will integrate multi-mode radar, advanced navigation and attack systems and enhanced self-protection systems into the existing aircraft under a

program known as F-5BR. In March 2002, we formed a consortium with Dassault, Thales and SNECMA to bid on the development and manufacture of up to 24 fighter jets for the Brazilian Air Force. The planned jet, the Mirage 2000 BR, is modeled on the Dassault Mirage 2000-5 supersonic jet. As leaders of the consortium, we would have coordination and management responsibilities in the program. As a result of this consortium and as part of our strategic alliance agreement, Dassault would transfer to us the technology for the Mirage, enabling us to have full control over the project technology as well. In addition, we intend to market our Legacy line of corporate jets to the Brazilian and other governments, modified to meet the added security needs of these customers. For example, we entered into a contract with the Belgian Air Force for two EMB 135s and two EMB 145s modified to transport government officials, of which two EMB 135s and one EMB 145 were delivered in 2001 and one EMB 145 was delivered in 2002.

Competition

Our defense products face competition from various manufacturers, many of which have greater financial, marketing and other resources than we do. The Super Tucano and the AL-X compete with the Pilatus PC-9M and the Raytheon T-6A Texan II. The EMB 145 AEW&C competes against the Northrop-Grumman E-2C II Hawkeye 2000 and the Lockheed-Martin C-130J AEW&C. In addition, Boeing has announced that it will develop the B737 AEW&C aircraft, with advanced warning and remote sensor capabilities, which is expected to enter the market in 2005. The AM-X/AMX-T competes with the British Aerospace Hawk-100, the Aermacchi MB-339FD and the Aero Vodochody L-159.

Corporate Jet Business

We have developed a line of corporate jets, the Legacy, based on our ERJ 135 regional jet. We are marketing the new line of corporate jets to businesses, including fractional ownership companies. Our corporate jet business accounted for 5.7% of our net sales for the year ended December 31, 2002, resulting from the delivery of eight Legacy jets.

We offer our line of corporate jets in two versions: executive and corporate shuttle. The Legacy was designed to provide customers with a cost-effective alternative to commercial regional airline travel. The executive version features a highly customized interior based on the customer's specific requirements. The corporate shuttle version is partially customized and is generally intended to have business class type seating and in-flight office design features. Both versions of our line of corporate jets have a maximum cruising speed of Mach .8, or 470 knots.

We developed our line of corporate jets by building upon our extensive regional jet design and manufacturing experience. For example, with the exception of the interior of the aircraft, the fuel tank, controller and indication system and the winglets, the Legacy has the same components as the ERJ 135 and is capable of being manufactured on the same production line. Furthermore, the corporate shuttle version of the Legacy does not require separate FAA, European aviation authority or Brazilian aviation authority approval. The executive version of the Legacy was certified by the Brazilian aviation authority in December 2001, by the JAA in July 2002 and by the FAA in August 2002. As a new entrant to the corporate jet market, we face significant competition from companies with longer operating histories and established reputations in this industry. Many of these manufacturers have greater financial, marketing and other resources than we do. These competitors include Dassault Aviation, Cessna Aircraft Co., Bombardier Inc., Israel Aircraft Industries, General Dynamics and Raytheon.

We take orders and build backlog for our line of corporate jets in the same manner as for our regional aircraft. We include an order in backlog once we have received a firm commitment, represented by a signed contract. We customarily receive a deposit at the time of order, three 5% progress payments and full payment of the balance due upon delivery, in the same manner as for our regional aircraft. We generally receive US\$100,000 for each option to purchase a corporate jet, with the terms of the options being substantially the same as those for our regional aircraft.

Other Related Businesses

We also provide after-sales customer support services and manufacture and market spare parts for the aircraft we produce. Activities in this segment include the sale of spare parts, maintenance and repair, training and other product support services. In addition, we provide structural parts and mechanical and hydraulic systems to Sikorsky Corporation for its production of helicopters. We also manufacture, on a limited basis and upon customer request, general aviation propeller aircraft, such as executive aircraft and crop dusters. Our other related businesses accounted for 5.7% of our net sales for the year ended December 31, 2002.

We entered into a joint venture with Liebherr International AG to develop and manufacture landing gear and high precision hydraulic equipment and provide related services for Embraer and other clients around the world. In connection with this joint venture, we formed a new subsidiary, ELEB, to which we transferred all of our landing gear manufacturing activities, the employees and some liabilities related to those activities. On May 22, 2000, Liebherr International AG, acting in coordination with its subsidiary, Liebherr Aerospace Lindenberg GmbH, and through its Brazilian affiliate, purchased 40% of the capital stock of ELEB. Liebherr-Aerospace SAS is our risk-sharing partner responsible for designing, developing and manufacturing the landing gear assemblies for the new EMBRAER 170/190 jet family.

After-Sales Customer Support; Spare Parts Business

We also provide after-sales customer support services and manufacture and market spare parts for the fleets of our regional and defense customers. Our after-sales customer support and spare parts business falls into several categories:

field support;

material support, which includes spare parts sales and distribution;

warranty and repair administration;

technical support, which includes engineering support, maintenance engineering and technical publications; and

training.

This business is expected to continue to grow as the number of our aircraft in service grows. Our customers require aircraft manufacturers and their suppliers to maintain adequate spare parts and ground support equipment inventories for a period of 10 years after the production of the last aircraft of the same type, or until fewer than five aircraft are operated in scheduled commercial air transport service. We recently established a pooling program that allows customers to exchange used parts for new or refurbished parts. As we deliver the aircraft we have in our backlog, we expect our after-sales support and spare parts business to grow proportionately. See **Customer Service and Product Support** below for a further discussion of our customer service facilities and arrangements.

Subcontracting

We provide subcontracting services to Sikorsky Corporation in connection with the development and manufacture of the landing gear, fuel system and fuel tanks for the S-92 Helibus helicopter. We also act as a risk-sharing partner to Sikorsky. The contracts expire in 2015.

General Aviation Aircraft

We build general aviation propeller aircraft. These six-passenger aircraft are produced only on demand and are used by corporations as executive aircraft and by air-taxi companies. At December 31, 2002, we had delivered a total of 2,326 of these aircraft. We also developed a crop duster aircraft pursuant to specifications of the Brazilian

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Ministry of Agriculture. These aircraft are produced only on demand. At December 31, 2002, we had delivered a total of 862 of these aircraft.

Markets

The following table sets forth our net sales by line of business and geographic region of the end users of our aircraft for the periods indicated.

	Year ended December 31,		
	2000	2001	2002
	(in millions of dollars)		
Regional Aircraft:			
Americas (excluding Brazil)	US\$ 1,377.0	US\$ 1,800.7	US\$ 1,772.2
Europe	1,021.1	644.5	290.5
Brazil		18.1	
Other	55.0	89.2	47.6
	US\$ 2,453.1	US\$ 2,552.5	US\$ 2,110.3
Corporate Jets			
Americas (excluding Brazil)	26.5	72.6	86.6
Europe			58.3
	US\$ 26.5	US\$ 72.6	US\$ 144.9
Defense Aircraft			
Americas (excluding Brazil)		US\$ 6.9	US\$ 13.3
Europe	26.8	74.0	73.5
Brazil	72.4	43.1	40.5
	US\$ 99.2	US\$ 124.0	US\$ 127.3
Other Related Business	US\$ 183.4	US\$ 177.9	US\$ 143.3

In addition, in an attempt to expand into new markets, we entered into a joint venture in December 2002 with Harbin Aircraft Industry (Group) Co., Ltd. and Hafai Aviation Industry Co., Ltd., subsidiaries of China Aviation Industry Corp. II, or AVIC II, to provide for the manufacture, sale and after-sale support of the ERJ 145 regional jet family. We own 51% of the equity of the joint venture company, Harbin Embraer Aircraft Industry Company Ltd. We have licensed to the joint venture the exclusive rights to produce, sell and provide support for the ERJ 145 regional jet family in the Chinese markets, and we will contribute US\$12.8 million in cash and tooling to the joint venture in 2003. Our joint venture partners have contributed the land use rights in Harbin, China and will contribute US\$12.7 million in cash and facilities to the joint venture in 2003. First deliveries by the joint venture company are scheduled for December 2003.

Suppliers and Components; Risk-Sharing Arrangements

We do not manufacture all of the parts and components used in the production of our aircraft. Approximately 84% to 90% of the production costs of our ERJ 145 regional jet family, depending on aircraft model, consist of materials and equipment purchased from our risk-sharing partners and other major suppliers. Risk-sharing arrangements with suppliers of key components enable us to focus on our core business: design and production of regional aircraft. Risk-sharing arrangements are those in which suppliers are responsible for the design, development and manufacture of major components or systems of our aircraft, such as wings, tail or fuselage. Our risk-sharing partners, therefore, must invest their own money in research and development and share the risk and success of our products with us.

In our regional jet business, we rely on risk-sharing partners to supply vital components of our aircraft, such as the engines, hydraulic components, avionics, wings, sections of the fuselage and portions of the tail. Once we select our risk-sharing partners and program development

and aircraft production begins, it is difficult to substitute these partners. In some cases, our aircraft are designed specifically to accommodate a particular component, such as the engines, which cannot be substituted by another manufacturer without significant delay and

expense. This dependence makes us susceptible to the performance, quality and financial condition of these risk-sharing partners.

ERJ 145 Regional Jet Family

Risk-sharing partners. We entered into risk-sharing arrangements with the following four suppliers in connection with the development and production of the ERJ 145 regional jet family:

Grupo Auxiliar Metalúrgico S.A., or Gamesa, is a Spanish company owned by Iberdrola S.A., a European power utility, and Banco Bilbao Vizcaya, a large Spanish financial institution. Gamesa supplies the wings, engine nacelles and main landing-gear doors;

Sonaca S.A. Société Nationale de Constructions Aéropatiales, a Belgian company, supplies portions of the central and rear fuselages, the service, main and baggage doors and engine pylons;

ENAER Empresa Nacional de Aeronáutica, a Chilean company, supplies the vertical fin, horizontal stabilizers and elevators; and

C&D Aerospace, Inc., a U.S. company, supplies the cabin and cargo compartment interiors.

Our risk-sharing partners generally receive payment for supplied components within three to five months after delivery of the components to Embraer. The partnering relationship with these suppliers results in lower production costs and higher product quality for the ERJ 145 regional jet family. Our line of corporate jets benefits from the risk-sharing arrangements with Gamesa, Sonaca and ENAER. In addition, the interior of the executive version of the Legacy will be provided by The Nordam Group, Inc.

Other suppliers. We have also entered into other agreements with numerous European, American, Canadian and Brazilian suppliers to provide key components for a number of our products, including the ERJ 145 regional jet family. These supply arrangements cover systems and components such as engines, avionics, landing gear and flight control systems. Our suppliers include, among other companies, Rolls-Royce Allison, Parker Hannifin Corp., BF Goodrich Co., United Technologies Corp. Hamilton Sundstrand Division, Honeywell, Rosemount Aerospace and Alcoa Inc.

We select suppliers on the basis of, among other factors, technical performance and quality of their products, production capacity, prior relationship and financial condition. We have had continuing relationships with most of our major suppliers since production of the Bandeirante aircraft began in 1975. We have entered into purchase agreements with our major suppliers, which cover our requirements for five to ten years of production. Our ongoing supplier relationships depend on cooperation, performance and the maintenance of competitive pricing.

EMBRAER 170/190 Jet Family

We are developing the EMBRAER 170/190 jet family together with risk-sharing partners that will supply key systems for the aircraft. Our supplier arrangements for the EMBRAER 170/190 jet family will differ from the ERJ 145 regional jet family in that we intend to use fewer suppliers. In the EMBRAER 170/190 jet family, each risk-sharing partner will be responsible for the development and production of aircraft systems, such as the landing gear, the hydraulic system and the flight control system, rather than individual components, and fewer components will be supplied by companies that are not risk-sharing partners. The assumption of responsibility for systems by our risk-sharing partners lowers our capital expenditures and thereby decreases our development risks, increases our operating efficiency by reducing the number of suppliers per product and cutting production costs. It also shortens development and production time. The primary risk-sharing partners for the EMBRAER 170/190 jet family are the following:

General Electric supplies CF34-8E/10E turbofan engines and designs, develops and manufactures the engine nacelles;

Honeywell supplies the avionics systems;

Liebherr is responsible for designing, developing and manufacturing the landing gear assemblies;

Kawasaki, a Japanese company, develops and manufactures the aircraft wing stub, engine pylon, fixed landing and trailing edge assemblies, flaps, spoilers and the wing's flight control surfaces;

Hamilton Sundstrand, a U.S. company and a wholly owned subsidiary of United Technologies Corp., develops and produces the aircraft's tail core, auxiliary power unit, electrical systems and the air management system;

Sonaca is responsible for the aircraft's wing slats;

Gamesa is responsible for the rear fuselage and the vertical and horizontal tail surfaces;

Latecoere, a French company, manufactures two of the three fuselage sections;

C&D Aerospace designs, develops and manufactures the aircraft interior; and

Grimes Aerospace Company, a U.S. company and a wholly owned subsidiary of AlliedSignal Inc., develops and manufactures the exterior and cockpit lighting.

If we cancel the development of the EMBRAER 170/190 jet family because we are unable to obtain certification of the aircraft from the applicable regulatory authorities or for other reasons, then we may be obligated to refund up to the full amount of the cash contributions from these suppliers. However, we generally do not need to refund these contributions as a result of insufficient market demand. At the same time, our rights to the cash contributions also depend on satisfactory completion of a number of steps in our production process. We believe that these financial commitments are a strong endorsement of our aircraft design and our ability to execute our business plan.

Furthermore, some of the risk-sharing partners for the EMBRAER 170/190 jet family will assume a broader role in other aspects of the program by providing sales financing and residual guarantees, rather than simply supplying us with aircraft components.

Customer Service and Product Support

Customer satisfaction and service is critical to our success. We will continue to focus on the development of closer, long-term relationships with our customers by meeting their aircraft requirements, providing after-sale support and spare parts and meeting maintenance requirements. We identify at the time of purchase the appropriate level of after-sale regional or on-site customer support and coordinate regional inventory levels to address expected spare parts and maintenance requirements. To maintain and increase our responsiveness, we have established five support centers worldwide. We have also outsourced distribution services through a facility in Weybridge, United Kingdom. We provide technical assistance, support and distribution to our Brazilian and other Latin American customers through our facility in São José dos Campos. In March 2002, we established a distribution Center in Beijing, China together with China Aviation Supplies Import and Export Corporation (CASC). We also intend to provide support services through our joint venture in China for aircraft sold by the joint venture. In March 2002, we acquired the operating assets of Celsius Aerotech Inc. in Nashville, Tennessee from Reliance Aerotech Inc. We provide full service maintenance and repair services for our regional and corporate aircraft at this Nashville service center, enhancing our level of service to our customers in the United States. Through our customer focus, we aim to enhance customer loyalty and, ultimately, increase sales.

We have dedicated teams in the United States, Europe and Brazil to focus exclusively on enhancing customer support. In addition, for each of our key customers, we have assigned senior relationship managers that are responsible for enhancing our relationships with these customers. We also provide direct field support with on-site technical representatives at several of our major customers' facilities. These on-site representatives are assigned

to major customers prior to the first delivery of their aircraft and provide advice on maintenance and operation. They also monitor our customers spare parts needs and maintain customers' inventories.

We provide support centers that are available 24 hours a day, seven days per week, in our São José dos Campos facility as well as in Ft. Lauderdale, Florida, USA; Le Bourget, France; and Melbourne, Australia. We train pilots, co-pilots, flight attendants and mechanics at these locations. We operate advanced flight simulators for our ERJ 145 regional jet family and for the Legacy at our Florida facility under an agreement with FlightSafety International, Inc., a business specializing in flight simulation. We have entered into an agreement with GE Capital Aviation Training Limited, or GECAT, a joint venture between General Electric Company and Thales, whereby GECAT will provide training for the EMBRAER 170/190 jet family on a non-exclusive basis. We also provide field service and on-the-job training for airline personnel. For example, we routinely dispatch one of our pilots to fly with an operator's crew during the introduction of an aircraft into a customer's regular routes. We also provide technical publications with up-to-date technical information on our aircraft. In addition, in 2001 we launched a new website, AEROChain, to provide a web-based platform for the exchange of information with our suppliers and customers. Through AEROChain, suppliers may view supply chain information and customers may make purchases as well as obtain technical services and learn aircraft maintenance, repair and overhaul techniques.

Aircraft Financing Arrangements

We generally do not provide long-term financing directly to our customers. We assist our customers in obtaining financing arrangements through different sources such as leasing arrangements and the BNDES-*exim* program. In addition, we help our customers qualify for the ProEx program. On a case by case basis, we have provided short-term financing, at market rates, to customers who have completed or are negotiating other financing arrangements and have not received funding in time for delivery. We have also provided guarantees for a portion of the financing of aircraft for certain of our customers. See Notes 7, 8 and 37 to our consolidated financial statements.

We assist customers in their aircraft financing through leasing arrangements, principally through leasing companies, U.S. leveraged leases, U.K. tax leases and French tax leases. These arrangements accounted for approximately 64.0% of the firm orders (in terms of value) we had with our customers at December 31, 2002. Leasing arrangements through leasing companies generally involve the purchase by a leasing company of our aircraft under a customer's purchase contract and the lease of that aircraft to that customer. In leveraged leasing transactions, an investor will borrow a portion of the aircraft purchase price from a third party lender, purchase our aircraft and lease it to our customer. See Note 8 to our consolidated financial statements.

The BNDES-*exim* program, a Brazilian government-sponsored program, provides our customers with direct financing for Brazilian exports of goods and services. At December 31, 2002, approximately 48.0% of our backlog (in terms of value) was financed by the BNDES-*exim* program.

Our customers also benefit from the ProEx program, a Brazilian government-sponsored program of interest rate adjustments. Under the ProEx program, which is intended to offset Brazil's country risk, foreign customers that buy selected products made in Brazil, such as our aircraft, receive the benefits of interest rate discounts. A substantial percentage of our customers benefit from the ProEx program.

See Item 3D. Risk Factors Risks Relating to Embraer Any decrease in Brazilian government-sponsored customer financing, or increase in government-sponsored financing that benefits our competitors, may decrease the cost-competitiveness of our aircraft for a discussion of challenges to and pending negotiations regarding the ProEx program.

Intellectual Property

Our intellectual property, which includes designs, trade secrets, know-how and trademarks, is important to our business. We hold trademarks over our name and symbol, and the names of our aircraft, some of which are registered and some of which are in the process of registration in a number of countries, including Brazil, the United States, Canada, Singapore, Hong Kong, China and in the European Union. At December 31, 2002, we had approximately 44 trademarks. Our registered trademarks are generally renewed at the end of their validity period,

which usually runs from 10 years from the date of application for registration. Brazil provides mechanisms to protect trademarks that are similar to the federal registration systems available in the United States.

Government Regulation and Aircraft Certification

We are subject to regulation by several regulatory agencies, both in Brazil and abroad. These agencies principally regulate certification of aircraft and of manufacturers. We must obtain certification in each jurisdiction in which our aircraft operate commercially. In addition, our products are subject to regulation in Brazil and in each jurisdiction where our customers are located. The competent authority for the certification of our aircraft in Brazil is the *Departamento de Aviação Civil*, or DAC (Civil Aviation Department), through the Brazilian Aviation Register RAB, currently under the supervision of the Ministry of Defense. However, the Brazilian Congress is presently considering a proposed law that aims to replace the DAC with an independent regulatory agency to be named *Agência Nacional de Aviação Civil*, or ANAC (National Civil Aviation Agency), which will then be the competent Brazilian authority for the ruling, supervision and certification of aircraft and commercial aircraft operations. The aviation authorities in other countries include the FAA, the JAA, the European aviation authority and the Chinese aviation authority. Some countries simply validate and complement the Brazilian aviation authority's original certification, following their own rules. The Brazilian aviation authority has entered into a bilateral certification agreement with the FAA under which most of the FAA's certification requirements are included in the Brazilian aviation authority's certification process. This cooperation among regulatory authorities leads to a faster certification process. The ERJ 145 received certification to operate in the United States and Brazil in the last quarter of 1996, in Europe in the second quarter of 1997, in Australia in June 1998 and, for the LR version, in China in November 2000. The ERJ 145 XR version was certified by the Brazilian aviation authority in August 2002 and by the FAA in October 2002. The ERJ 135 was certified by the Brazilian aviation authority in June 1999, by the FAA in July 1999 and by the European aviation authority in October 1999. The ERJ 140 was certified by the Brazilian aviation authority in June 2001 and by the FAA in July 2001. The executive version of the Legacy was certified by the Brazilian aviation authority in December 2001, by the JAA in July 2002 and by the FAA in August 2002.

The EMBRAER 170 is expected to be certified by the Brazilian aviation authority, the FAA and the JAA by the end of 2003. The EMBRAER 175, EMBRAER 190 and EMBRAER 195 will need to be certified by the relevant authority prior to delivery.

The FAA exercises strong influence over other authorities, such as the Brazilian aviation authority and the aviation authority in Canada, and its regulatory approval process is frequently followed by other regulatory bodies, such as the aviation authority in Australia. In Europe, 27 affiliated countries operate under the rules of the JAA. The JAA is not a certification authority itself, but makes recommendations to several national authorities, such as the aviation authorities of Germany, France, the United Kingdom, Spain and The Netherlands. A recommendation by the JAA is a requirement for certification of an aircraft by the aviation authorities of most European countries. Each affiliated country has the right to adopt new rules or complement the JAA's recommendations as it sees fit. A new European aviation authority is expected to be created, to be called the European Aviation Safety Agency EASA, and will replace the JAA. EASA will be the official certification authority for the European Union in the near future. Certification is an ongoing process. Significant changes in the design of an aircraft may require a separate certification. For example, the LR version of the ERJ 145 had to be certified separately by all relevant authorities due to its structural and design changes. However, any change in the aircraft certification rules themselves will not require recertification of an aircraft already certified.

4C. Organizational Structure

Our operations are conducted by Embraer Empresa Brasileira de Aeronáutica S.A. as the controlling and principal operating company. We have a number of direct and indirect subsidiaries, none of which are considered significant.

4D. Property, Plants and Equipment

We own our headquarters and plant, located in São José dos Campos. Significant portions of our facilities in São José dos Campos are subject to mortgages held by BNDES and Banco do Brasil S.A. We lease, own or have the right to use the following properties:

Location	Purpose	Approximate square footage	Owned/Leased	Lease expiration
São José dos Campos, SP, Brazil	Headquarters, principal manufacturing facility and support center	5,902,102	Owned	
São José dos Campos, SP, Brazil (Eugênio de Mello)	Manufacturing facility	3,658,884	Owned	
Botucatu, SP, Brazil	Manufacturing facility	222,000	Owned	
Harbin, China	Manufacturing facility	258,067	Owned*	
Gavião Peixoto, SP, Brazil	Testing and manufacturing facilities	191,648,512	**	
São Paulo, SP, Brazil	Administrative offices	5,245	Leased	2007
Ft. Lauderdale, Florida, U.S.A.	Support center	91,500	Leased	2020
West Palm Beach, Florida, U.S.A.	Engineering offices	16,800	Leased	2005
Dallas, Texas, U.S.A.	Administrative offices	1,600	Leased	2003
Nashville, Tennessee, U.S.A.	Aircraft maintenance and support center	125,260	Leased	2018
Le Bourget, France	Support center	33,500	Leased	2008
Melbourne, Australia	Support center	12,126	Leased	2003
Beijing, China	Representative offices	1,709	Leased	2004
Singapore	Representative offices	2,239	Leased	2004

* Land owned pursuant to a land use rights certificate.

** We currently have a temporary authorization from the State of São Paulo to use this facility and expect to receive a concession for the use of this facility as soon as legal formalities are satisfied.

Production

The actual manufacture of an aircraft consists of three principal stages: fabrication of primary parts, assembly of major components and final assembly. Primary parts include metal sheets and plates (produced from die-cast molds, stretch forming or various chemical treatments), parts produced using computerized and non-computerized machines, and pre-fabricated parts. The primary parts are then joined, or mated, with one another to produce the aircraft's major components, which are in turn joined to create the aircraft's basic structure. In the final assembly stage, the aircraft's various operating systems (such as wiring and electronics) are installed into the structure and tested.

Production facilities for our regional and defense aircraft are located in São José dos Campos in the State of São Paulo, Brazil. We reduced the aircraft production time of our regional jet aircraft from eight months in 1996 to 3.7 months in 2002. From December 31, 1999 to December 31, 2000, we increased our production rate from 12 to 16 aircraft per month. At March 31, 2001, our production rate was 16 aircraft per month. We have since decreased our production to 11 aircraft per month in response to decreased market demand after the September 11th terrorist attacks and the global economic slowdown. We have the flexibility to increase production in the future in response to increased demand. We build the EMB 120 Brasília according to market demand and adjust production accordingly. To accommodate our current production of the ERJ 145 regional jet family and the start of production of the EMBRAER 170/190 jet family, as well as any production of the line of corporate jets, we have expanded our production facilities and acquired new facilities and will continue to coordinate with our risk-sharing partners.

We are constructing a new facility in Gavião Peixoto, in the State of São Paulo, Brazil, which we anticipate will be used to enhance our flight testing capabilities and provide a final assembly line for our defense and corporate aircraft. As of December 31, 2002, we had invested US\$35.6 million in the construction of this new facility. This facility has been operational since November 2002 and consists of a runway and other features to handle our development of supersonic aircraft technology, as well as to handle flight tests for our EMBRAER 170/190 jet family. The runway has been completed, the hangars have been built and we conducted our flight tests for the EMBRAER 170 from this runway. In addition, in September 2000, we purchased a new facility in São José dos Campos in the State of São Paulo, Brazil, where we currently manufacture small parts and components for our aircraft. Our China joint venture is also in the process of building a production facility for the ERJ 145 jet family in Harbin, China.

Environmental Matters

Most environmental regulation in Brazil is established at the state rather than at the federal or municipal level, with environmental authorities, in most states, granting operating permits to individual facilities rather than through general regulations. We have all material permits required to operate our business. The terms of these operating permits are reviewed every year and we are in compliance with our permits. In addition, we adhere internally to international ISO 14000 environmental standards. In 2000, 2001 and 2002, we invested US\$0.6 million, US\$1.1 million and US\$1.0 million, respectively, in environmental matters and we anticipate spending approximately US\$1.2 million on environmental matters in 2003 for expenditures relating to the portion of construction of new facilities and modification of existing facilities relating to environmental compliance and improvements.

Insurance

We insure all of our plants and equipment for loss and replacement. We also carry insurance to cover all potential damages to our own fleet of aircraft, including those occurring during commercial and demonstration flights. In addition, we maintain a comprehensive aviation products liability policy, which covers damages arising out of the manufacture, distribution, sale and servicing of our aircraft and parts. We have been increasing our coverage for aviation products liability as our fleet has grown. We also carry natural disaster and business interruption insurance covering property damage and the related loss of gross income, as defined in the policy, and additional expenses, such as those incurred by us to offset the loss of production and delivery of aircraft due to partial or total interruption of our business because of material losses caused by an accident. We consider the amounts of our insurance coverage to be typical for a company of our size and adequate to meet all foreseeable risks associated with our operations.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

This discussion should be read in conjunction with our consolidated financial statements and notes thereto and other financial information included elsewhere in this annual report. This annual report contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those discussed in the forward-looking statements as a result of various factors, including, without limitation, those set forth in Item 3D, Risk Factors and the matters set forth in this annual report generally.

Except as otherwise indicated, all financial information in this annual report has been prepared in accordance with U.S. GAAP and presented in U.S. dollars. For certain purposes, such as providing reports to our Brazilian shareholders, filing financial statements with the Comissão de Valores Mobiliários, or CVM, the Brazilian securities commission, and determining dividend payments and other distributions and tax liabilities in Brazil, we have prepared and will continue to be required to prepare financial statements in accordance with the Brazilian Corporate Law.

5A. Operating Results

Critical Accounting Policies

In connection with the preparation of the financial statements included in this annual report, we have relied on variables and assumptions derived from historical experience and various other factors that we deemed reasonable and relevant. Although we review these estimates and assumptions in the ordinary course of business, the portrayal of our financial condition and results of operation often requires our management to make judgments regarding the effects of matters that are inherently uncertain. Actual results may differ from those estimated under different variables, assumptions or conditions. Note 3 to our consolidated financial statements includes a summary of the significant accounting policies and methods used in the preparation of these financial statements. In order to provide an understanding about how management forms its judgments about future events, including the variables and assumptions underlying the estimates, and the sensitivity of those judgments to different variables and conditions, we have included below a brief discussion of our more significant accounting policies.

Sales and Other Operating Revenues

We generally recognize sales of our regional and commercial aircraft as deliveries are made. In our defense aircraft segment, we perform work under long-term development contracts for the Brazilian government and other governments, and we recognize revenue in accordance with the percentage of completion method. Revenue recognized under this method is based on our estimate of our progress towards completion. Certain contracts contain provisions for the redetermination of price based upon future economic conditions. Anticipated losses, if any, under these contracts are accrued when known and are recorded based on management's estimate of such losses.

Product Warranties

Generally, aircraft sales are accompanied by a standard warranty for systems, accessories, equipment, parts and software manufactured by us. We recognize warranty expense, as a component of selling expenses, at the time of sale based on the estimated amounts of warranty costs expected to be incurred, which are typically expressed as a percentage of the sales price of the aircraft. These estimates are based on a number of factors including our historical warranty claim and cost experience, the type and duration of the warranty coverage, volume and mix of aircraft sold and in service and warranty coverage available from the related suppliers. The warranty period ranges from two years for spare parts to five years for components that are a part of the aircraft when sold.

We have provided guarantees of specified minimum levels of aircraft performance based on pre-determined operational targets. Costs resulting from a failure to meet these targets cannot be established until after delivery of the aircraft. In the event that these target levels are not met, we may be obligated to pay amounts to the affected customers as reimbursement for their incremental operating or service costs. Losses related to such performance guarantees are recorded at the time they are known, or when circumstances indicate that the aircraft is not expected to meet the minimum performance requirements, based on management's estimate of our ultimate obligation under

the guarantee. In some cases, we may also be obligated to make modifications after aircraft delivery due to improvement or performance of aircraft. The costs related to these modifications are accrued when known.

Guarantees, Repurchase Commitments and Trade-Ins

We have provided sales incentives in the form of financial and residual value guarantees, repurchase commitments and trade-in rights related to our aircraft. We review the value of these commitments relative to the aircraft's anticipated future fair value and, in the case of financial guarantees, the creditworthiness of the obligor. Provisions and losses are recorded when and if payments become probable and are estimable. We estimate future fair value using third party appraisals of aircraft valuations, including information developed from the sale or lease of similar aircraft in the secondary market. We evaluate the creditworthiness of obligors for which we have provided credit guarantees by analyzing a number of factors, including third party credit ratings and estimated obligors' borrowing costs.

Credit Risk

Credit risk is the risk that we may incur losses if counterparties to our contracts do not pay amounts owed to us. Our primary credit risk derives from the sales of aircraft, parts and related services to our customers, including the financial obligations related to these sales.

We grant credit to our customers for the sale of spare parts and services based upon an evaluation of the customers' financial condition and credit history. Customer credit analyses are continuously monitored and we establish an allowance for doubtful accounts based upon factors that include the credit risk of specific customers and historical aging, collection and write-off trends. Our historical experience in collecting accounts receivable falls within the recorded allowances.

We may also have credit risk related to the sale of aircraft while our customers are finalizing the financing structures for their purchases from us. To minimize these risks, customer credit analyses are continuously monitored and we work closely with the financial institutions to help facilitate customer financing.

We have recognized an allowance for doubtful accounts, which we believe is sufficient to cover potential losses on the realization of accounts receivable.

Property, Plant and Equipment

Property, plant and equipment are stated on our balance sheet at cost. Depreciation is calculated using the straight line method over the estimated useful life or utility of the assets. Improvements to existing property that significantly extend useful life or utility are capitalized. We review long-lived assets for impairment annually or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by comparison of the carrying amount of the asset to our estimate of undiscounted future net cash flows expected to be generated by the asset. If we conclude that an asset is impaired, we recognize the impairment as the amount by which the carrying amount of the asset exceeds its fair value. We report assets to be disposed of at the lower of the carrying amount or fair value less cost to sell.

Provisions for Contingencies

We are subject to contingencies for labor, tax, commercial and civil litigation in the ordinary course of our business. We record losses for these contingencies when we determine that the loss is probable and can be reasonably estimated. Our assessment of the probability and amount of loss is based on a number of factors, including legal advice and our management's estimate of the likely outcome.

Recent Trends in the Airline Industry

The commercial aviation industry has been negatively impacted by a number of factors beginning in 2001. First, the U.S. and world economies have been experiencing an economic downturn that began in 2001 and is characterized by rapid declines in securities markets, a decline in productivity and an increase in unemployment. Second, the terrorist attacks of September 11th caused an immediate decline in airline travel and a high level of financial uncertainty among the worldwide airline industry. Many airlines faced, and continue to face, a reduction in demand, escalating insurance costs, increased security costs, increasing fuel costs and, in some cases, credit downgrades, liquidity concerns and bankruptcy. Finally, airline travel decreased significantly in 2003 as a result of both the commencement of military action by the United States and other countries in Iraq and the concerns over outbreaks of severe acute respiratory syndrome (SARS) in Asia and Canada. In response to these events, beginning in the fourth quarter of 2001 many airlines, including our largest customers, reduced their flight schedules for the long-term and announced significant lay-offs. As a result, we agreed to modify certain delivery schedules to adjust to the changes in our customers' businesses and have reduced scheduled regional, corporate jet and government transportation aircraft deliveries in 2002 to 131 aircraft

as compared to planned 2002 deliveries of 205 at August 31,

2001 and reduced 2003 scheduled deliveries to 110 aircraft from planned 2003 deliveries of 148 as of December 31, 2002. In addition, the economic downturn has caused us to revise our risk metrics related to our financial guarantees and re-evaluate our exposure. A further downturn in general economic conditions could result in further reduction in the passenger aircraft market, decreased orders for our regional aircraft, increased exposure to financial guarantees and additional charges against income. We cannot, at this time, predict the magnitude or duration of the impact that these events will have on the airline industry as a whole and on our business in particular.

In addition, the above events and the ensuing negative effects on the U.S. economy have adversely affected the global and Brazilian economies and securities markets, and have resulted in:

increased volatility in the market price of securities;

significant decline in corporate earnings estimates;

substantial losses in important industries, including the air transport and insurance industries; and

significant erosion of consumer confidence.

The uncertainty surrounding U.S., Brazilian and global economies could in turn lead to the Brazilian government changing existing laws or regulations or imposing new ones, and/or the Central Bank changing base interest rates, which could adversely affect our operations.

Brazilian Economic Environment

The Brazilian economy has been characterized by frequent and occasionally drastic intervention by the Brazilian government and by volatile economic cycles. The Brazilian government has often changed monetary, taxation, credit, tariff and other policies to influence the course of Brazil's economy. For example, the Brazilian government has the authority, when a serious imbalance in Brazil's balance of payments occurs, to impose restrictions on the remittance to foreign investors of the proceeds of their investments in Brazil and on the conversion of Brazilian currency into foreign currencies. Furthermore, Brazilian courts may issue rulings that could adversely affect foreign investors or Brazilian political and economic conditions. In late September 1999, a court in the State of Minas Gerais ruled that the representatives on the board of directors of the minority foreign private partners of Companhia Energética de Minas Gerais, a privatized electric utility in that state, could no longer have veto power over corporate actions. In late October 2000, Brazil's Federal Supreme Court ruled that employee accounts in the Brazilian unemployment compensation fund for the months of January 1989 and April 1990 should have been adjusted using the real inflation rate in those months rather than the official inflation rate previously used. The Brazilian government has reached an agreement with the labor unions on this matter and is currently making settlement payments, which may have an adverse effect on Brazil's federal budget and, therefore, amounts available to us or our customers under Brazilian government financing programs. Changes in monetary, taxation, credit, tariff and other policies could adversely affect our business, as could inflation, currency and interest rate fluctuations, social instability and other political, economic or diplomatic developments, as well as the Brazilian government's response to such developments. See Item 3D. Risk Factors Risks Relating to Brazil.

Rapid changes in Brazilian political and economic conditions that have occurred and may occur in the future will require continued emphasis on assessing the risks associated with our activities and adjusting our business and operating strategy accordingly. Future developments in Brazilian government policies, including changes in the current policy and incentives adopted for financing the export of Brazilian goods, or in the Brazilian economy, over which we have no control, may materially adversely affect our business. See Item 3D. Risk Factors Risks Relating to Brazil.

Brazilian economic conditions may also be negatively affected by economic and political conditions elsewhere, particularly in other South American and emerging market countries. Although economic conditions are different in each country, the reaction of investors in one country, may cause the capital markets in other countries to fluctuate. Developments or conditions on other emerging market countries have at times significantly affected the

availability of credit in the Brazilian economy and resulted in considerable outflows of funds and declines in the amount of foreign currency invested in Brazil.

For example, since 1999, the Argentine economy has been in a recession marked by reduced levels of consumption and investment, increasing unemployment and declining gross domestic product. During late 2001, Argentine depositors withdrew their money from banks and sought to remit such funds abroad. In early December 2001, the government restricted the rights of such depositors to withdraw their funds. The economic crisis gave rise to increasing political instability and eventually led to the announcement by Argentina that it would impose a moratorium on the payment of its foreign debt. On January 3, 2002, Argentina formally defaulted on debt held by certain foreign creditors. On January 7, 2002, Argentina announced that it was devaluing its peso by 29%, ending the peso's decade-old one-to-one peg with the U.S. dollar. In 2002, the Argentine peso experienced a devaluation of over 200% against the U.S. dollar. The situation in Argentina has negatively affected investors' perceptions of risks in Brazil.

The recent political crisis in Venezuela may also influence investors' perception of risk in Brazil. The continuation of the Venezuelan and Argentine crises presents causes for concern relating to Brazil's economic stability. Although market concerns that similar crises would ensue in Brazil have not yet become a reality, the volatility in market prices for Brazilian securities increased in 2001 and 2002. Instability in the Brazilian financial markets caused by the Argentine and Venezuelan crises and other developments in the international financial markets may adversely affect our financial condition and, specifically, our ability to raise capital when needed and the market price of the preferred shares and ADSs.

The Brazilian government has also proposed a broad tax reform in Brazil, mainly designed to reduce the public deficit through the increase in tax collection. It is expected that the final tax reform bill will be submitted to the Brazilian Congress during 2003. It is anticipated that the reform will include the creation of a value-added tax on goods and services that would replace six existing taxes (including contribution for social purposes, the federal tax on industrial products and the state tax on circulation of goods and services). In addition, the *Contribuição Provisória sobre Movimentação Financeira-CPMF*, a provisional levy on checking account transactions, would be replaced by a permanent federal tax on financial transfers. We may have a higher tax burden if the tax reform bill is approved and implemented.

Effects of Inflation and Currency Exchange Fluctuations

Until July 1994, Brazil had for many years experienced high, and generally unpredictable, rates of inflation and steady devaluation of its currency relative to the U.S. dollar. The following table sets forth, for the periods shown, Brazilian inflation as measured by the General Market Index and published annually by Fundação Getúlio Vargas and the devaluation of the *real* against the U.S. dollar as measured by comparing the daily exchange rates published by the Central Bank on the last day of each year:

	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>
Inflation (General Market Price Index)	1.8%	20.1%	9.9%	10.4%	25.3%
Devaluation (appreciation) (R\$ vs. US\$)	8.3%	48.0%	9.3%	18.7%	52.3%

Inflation and exchange rate variations have had, and may continue to have, substantial effects on our financial condition and results of operations.

Inflation and exchange rate variations affect our monetary assets and liabilities denominated in *reais*. The value of such assets and liabilities as expressed in U.S. dollars declines when the *real* devalues against the U.S. dollar and increases when the *real* appreciates. In addition, many financial instruments denominated in *reais* are indexed for inflation. In periods of devaluation of the *real*, we report (a) a remeasurement loss on *real*-denominated monetary assets, which is offset, at least in part, by monetary indexation of *real*-denominated financial instruments and (b) a remeasurement gain on *real*-denominated monetary liabilities, which is offset, at least in part, by the monetary indexation of *real*-denominated financial instruments.

Finally, because revenues in our defense business have historically been denominated principally in *reais*, while our costs for materials for this segment have been principally denominated in U.S. dollars, devaluation of the *real* has adversely affected margins in our defense business. However, at the anniversary date of each contract we are able, under our defense contracts with the Brazilian government, to adjust prospectively our prices (in *reais*) upward to reflect the adverse effects of devaluation. As our defense business becomes more international and our defense sales more U.S. dollar-denominated, we expect that our defense business will be less exposed to devaluation of the *real*.

Overview

Basis of Presentation

The consolidated financial statements have been prepared in accordance with U.S. GAAP. See Introduction Presentation of Financial and Other Data Financial Data for a discussion of factors affecting our financial data.

Operating Data

The following chart sets forth statistical data concerning our deliveries and backlog for our aircraft at the end of the respective periods. Deliveries consist of aircraft that have been delivered to customers and for which the corresponding revenue has been recognized. Our backlog consists of all firm orders that have not yet been delivered. A firm order is a contractual commitment from a customer, customarily accompanied by a down payment, for which we have reserved a place on one of our production lines. See Item 5D. Trend Information for certain information on our firm orders and options.

	At December 31,		
	2000	2001	2002
Regional			
Deliveries			
ERJ 145	112	104	82
ERJ 135	45	27	3
ERJ 140		22	36
EMB 120 Brasília		2	
Defense			
Deliveries	2	3	7
Corporate			
Deliveries	2	5	8
Other Operating Information			
Total backlog (in millions)(1)	US\$11,421	US\$10,693	US\$9,034

(1) Subsequent to December 31, 2002, we received 126 net additional firm orders for our EMBRAER 170/190 jet family.

Net Sales

We generate revenue primarily from the sale of regional aircraft, which historically consists of our ERJ 145 regional jet family and our EMB 120 Brasília. We also generate revenue from the sale of defense aircraft, including the EMB 312 Tucano, the AM-X, and the EMB 145 AEW&C/RS/MP surveillance aircraft, and from the sale of our Legacy corporate jets. Net sales of regional aircraft and corporate aircraft are denominated in U.S. dollars. Of defense net sales, sales to the Brazilian government accounted for 31.8% in 2002. Finally, we generate revenue from our other related businesses, which include after-sales support (including the sale of spare parts, maintenance and repair, training and other product support services) and single-source supply of structural parts and mechanical and hydraulic systems to other aircraft manufacturers.

We recognize revenue for the sale of our regional and corporate aircraft when the aircraft is delivered to the customer. We customarily receive a deposit upon signing of the purchase agreement for the sale of our regional and corporate aircraft and progress payments in the amount of 5% of the sales price of the aircraft 18 months, 12 months and six months before scheduled delivery. For the EMBRAER 170/190 jet family, we receive an additional 5%

progress payment 24 months before scheduled delivery. We typically receive the remaining amount of the sales price upon delivery. Payments in advance of delivery are recorded under customer advances as a liability on our balance sheet and, when we deliver the aircraft, these payments are recorded as net sales.

As a result of a decrease in the amounts available under the ProEx program in 1999, we assisted some of our affected customers in restructuring their financing arrangements. In cases where we were not able to restructure these arrangements, we provided special price adjustments to these customers to maintain the effective interest rates in their original financing arrangements. Upon delivery of an aircraft to these customers, we record these price adjustments as deductions from gross sales on our income statement and under accounts payable on our balance sheet. These deductions amounted to 2.4% of our net sales in 2000, 1.3% of our net sales in 2001, and 1.0% of our net sales in 2002.

Our sales contracts with our customers typically include adjustments to the purchase price of the aircraft based on an escalation formula which reflects, in part, inflation in the United States. With respect to options to purchase our aircraft, we generally receive US\$100,000 for each aircraft in the ERJ 145 regional jet family and for each Legacy, US\$200,000 for each aircraft in the EMBRAER 170/190 jet family and US\$50,000 for each EMB 120 Brasília. The deposits, progress payments and option payments are generally non-refundable. Once a customer decides to exercise an option, we account for it as a firm order. We record each option payment as a customer advance on our balance sheet. If an option is exercised, we begin to receive progress payments and recognize revenue upon delivery as discussed above.

We recognize revenue from the sale of our defense aircraft, including the funding of the research and development for specific programs, in accordance with the percentage of completion method. Certain contracts contain provisions for the redetermination of price based upon future economic conditions. Our defense customers continue to provide customer advances, which are converted into revenue as we achieve pre-determined stages of completion of the project, such as conception, development and design, and engineering, systems integration and customization. These installments are generally non-refundable.

Cost of Sales and Services

Our cost of sales and services consists primarily of:

Material These costs are primarily U.S. dollar-denominated. Substantially all of our materials costs are covered by contracts with our suppliers. Prices under these contracts are generally adjusted based on an escalation formula which reflects, in part, inflation in the United States.

Labor These costs are primarily *real*-denominated.

Depreciation We depreciate our property, plant and equipment over their useful lives, ranging from five to 48 years, on a straight line basis.

Results of Operations

The following table presents income statement data by business segment.

Summary Financial Data by Business

	Operating income		
	Year ended December 31,		
	2000	2001	2002
	(in millions of dollars)		
Net sales:			
Regional	US\$2,453.1	US\$2,552.5	US\$2,110.3
Defense	99.2	124.0	127.3
Corporate	26.5	72.6	144.9
Other related businesses	183.4	177.9	143.3
	<u>2,762.2</u>	<u>2,927.0</u>	<u>2,525.8</u>
Cost of sales and services:			
Regional	(1,692.3)	(1,536.8)	(1,243.9)
Defense	(84.0)	(105.2)	(79.5)
Corporate	(18.8)	(47.0)	(104.6)
Other related businesses	(84.2)	(80.2)	(103.7)
	<u>(1,879.3)</u>	<u>(1,769.2)</u>	<u>(1,531.7)</u>
Gross profit:			
Regional	760.8	1,015.7	866.4
Defense	15.2	18.8	47.8
Corporate	7.7	25.6	40.3
Other related businesses	99.2	97.7	39.6
	<u>882.9</u>	<u>1,157.8</u>	<u>994.1</u>
Operating expenses:			
Regional	(122.6)	(161.9)	(177.5)
Defense	(14.9)	(20.9)	(15.7)
Corporate	(3.7)	(9.3)	(28.4)
Other related businesses	(52.5)	(61.0)	(30.8)
Unallocated corporate expenses	(227.1)	(253.3)	(272.1)
	<u>(420.8)</u>	<u>(506.4)</u>	<u>(524.5)</u>
Income from operations	<u>US\$462.1</u>	<u>US\$651.4</u>	<u>US\$469.6</u>

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The following table sets forth income statement information, and such information as a percentage of our net sales, for the periods indicated.

Year ended December 31,

	2000		2001		2002	
	(in millions of dollars, except percentages)					
Net sales	US\$2,762.2	100.0%	US\$2,927.0	100.0%	US\$2,525.8	100.0%
Cost of sales and services	(1,879.3)	68.0	(1,769.2)	60.4	(1,531.7)	60.6
Gross profit	882.9	32.0	1,157.8	39.6	994.1	39.4
Operating expense						
Selling expenses	(193.4)	7.0	(212.1)	7.2	(211.0)	8.4
Research and development	(69.6)	2.5	(99.6)	3.4	(158.5)	6.3
General and administrative	(96.6)	3.5	(120.8)	4.1	(109.7)	4.3
Employee profit sharing	(41.8)	1.5	(43.7)	1.5	(25.2)	1.0
Stock compensation	(0.5)		(1.1)			
Other operating expenses, net	(19.6)	0.7	(29.5)	1.0	(20.5)	0.8
Equity on income (loss) from affiliates	0.8		0.3		0.4	
Income from operations	462.1	16.7	651.4	22.3	469.6	18.6
Non-operating income (expense)						
Interest income (expenses)	(6.9)	0.2	47.5	1.6	80.5	3.2
Financial transaction gain (loss), net	(24.6)	0.9	(148.6)	5.1	(135.6)	5.4
Other non-operating income (expenses), Net	6.0	0.2	(8.4)	0.3	(1.4)	0.1
Income before income taxes	436.6	15.8	541.8	18.5	413.0	16.4
Provision for income taxes	(117.4)	4.3	(218.4)	7.5	(188.5)	7.5
Income before minority interest	319.2	11.6	323.4	11.0	224.5	8.9
Minority interest	1.5	0.1	(0.4)		(1.9)	0.1
Income before cumulative effect of accounting change	320.7	11.6	323.0	11.0	222.6	8.8
Cumulative effect of accounting change, net of tax			5.4	0.2		
Net income	US\$320.7	11.6%	US\$328.4	11.2%	US\$222.6	8.8%

2002 Compared with 2001

Net sales. Net sales decreased 13.7% from US\$2,927.0 million in 2001 to US\$2,525.8 million in 2002. Regional net sales decreased 17.3% from US\$2,552.5 million in 2001 to US\$2,110.3 million in 2002. Defense net sales increased 2.7% from US\$124.0 million in 2001 to US\$127.3 million in 2002. Corporate net sales increased 99.6% from US\$72.6 million in 2001 to US\$144.9 million in 2002. Net sales from other related businesses decreased 19.5% from US\$177.9 million in 2001 to US\$143.3 million in 2002.

The decrease in regional sales is primarily due to the rescheduling of customer deliveries from 2002 to 2003 and thereafter, partially offset by a better product mix and a higher average unit price. The increase in corporate net sales resulted from the start of deliveries of the Legacy at the end of 2001. The decrease in net sales from other related businesses is mainly due to a decrease in sales of spare parts, despite an increase in aircraft in service, due to the economic downturn and our customers' cost cutting measures.

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Cost of sales and services. Cost of sales and services decreased 13.4% from US\$1,769.2 million in 2001 to US\$1,531.7 million in 2002, principally due to the reduction in number of aircraft delivered during 2002. Cost of sales and services as a percentage of net sales was relatively stable at 60.6% in 2002, in comparison to 60.4% in 2001.

Gross profit. Our gross profit decreased 14.1% from US\$1,157.8 million in 2001 to US\$994.1 million in 2002, primarily as a result of the reduction in deliveries in the regional market. As a result of the decline in cost of sales and services, our gross margin remained relatively stable at 39.6% in 2001 compared to 39.4% in 2002.

Operating expenses. Operating expenses increased 3.6% from US\$506.4 million in 2001 to US\$524.5 million in 2002. This increase was attributable primarily to an increase of 37.2% in research and development from US\$99.6 million in 2001 to US\$158.5 million in 2002, principally related to higher development costs for the EMBRAER 170/190 and the new versions of our other regional and corporate jets as we approach the later stages of development. Research and development is presented net of contributions from suppliers, which are earned based on meeting specified milestones. In 2002, selling expenses remained relatively stable, despite lower deliveries, due to both a non-cash charge of US\$14.5 million related to financial guarantees and a US\$11.6 million increase in our provision for warranties relating to extended warranty terms for new aircraft deliveries. The US\$14.5 million non-cash charge was caused by the effect of the economic downturn in the airline industry on our risk analysis of financial guarantees.

This increase in operating expenses was partially offset by a 9.2% decrease in general and administrative expenses, from US\$120.8 million in 2001 to US\$109.7 million in 2002, a 42.3% decrease in profit sharing, from US\$43.7 million in 2001 to US\$25.2 million in 2002 and a 30.4% reduction in other operating expenses, net, from US\$29.5 million in 2001 to US\$20.5 million in 2002.

The decrease in general and administrative expenses is primarily due to the effects on the *real*-denominated portion of this item resulting from the 52.3% devaluation of the *real* during 2002. The decrease in profit sharing is related to the reduction in net income and dividends. Operating expenses as a percentage of net sales increased from 17.3% in 2001 to 20.8% in 2002, primarily as a result of the increases in research and development expenses as well as the non-cash charge for guarantees and the increase in our provision for warranties.

Interest income (expense). Interest income increased from US\$47.5 million in 2001 to US\$80.5 million in 2002, despite lower average cash balances primarily due to an increase of US\$65.3 million in unearned gains on derivative financial transactions and an increase in net monetary and exchange variations due to the effects of the devaluation of the *real* on increased indexed net liabilities in foreign currency, primarily taxes and social charges in dispute. See Notes 18 and 22 to our consolidated financial statements.

Financial transaction gain (loss), net. Financial transaction loss, net decreased from US\$148.6 million in 2001 to US\$135.6 million in 2002. These amounts reflect the restatement of non-U.S. dollar-denominated assets and liabilities into U.S. dollars and the decrease in net assets denominated in *reals*, partially offset by a higher rate of devaluation of the *reals* in 2002.

Other non-operating income (expense), net. Other non-operating expense, net decreased from US\$8.4 million in 2001 to US\$1.4 million in 2002. The decrease in 2002 was primarily due to a decrease in provisions for losses on tax incentive investments from US\$8.6 million in 2001 to US\$0.7 million in 2002.

Provision for income taxes. Our provision for income taxes decreased from US\$218.4 million in 2001 to US\$188.5 million in 2002 mainly due to lower taxable profits under the Brazilian Corporate Law financial statements. Our effective tax rate in 2002 was 45.6% as compared to 40.3% in 2001. Our statutory tax rate in each year was 34%. The difference between the statutory rate and the effective rates is due to differences in income before income taxes under U.S. GAAP and the taxable income calculated under the Brazilian Corporate Law.

Net income. As a result of the foregoing factors, our net income decreased 32.2% from US\$328.4 million in 2001 to US\$222.6 million in 2002. Net income decreased as a percentage of net sales. In 2001, net income was 11.2% of net sales as compared to 8.8% in 2002.

2001 Compared with 2000

Net sales. Net sales increased 6.0% from US\$2,762.2 million in 2000 to US\$2,927.0 million in 2001. Regional net sales increased 4.1% from US\$2,453.1 million in 2000 to US\$2,552.5 million in 2001. Defense net sales increased 25.0% from US\$99.2 million in 2000 to US\$124.0 million in 2001. In 2000, we entered the corporate jet market, which we account for as a separate business segment. Corporate net sales increased 174.0% from US\$26.5 million in 2000 to US\$72.6 million in 2001. Net sales from other related businesses decreased 3.0% from US\$183.4 million in 2000 to US\$177.9 million in 2001.

The increase in regional sales is primarily due to an increase in our average unit price. The decrease in defense sales is primarily due to the decrease in revenues related to research and development of the EMB 145 AEW&C/RS and the AL-X offset by the revenue resulting from deliveries of two EMB 135s and one EMB 145 to the Belgian Government.

Cost of sales and services. Cost of sales and services decreased 5.9% from US\$1,879.3 million in 2000 to US\$1,769.2 million in 2001, principally due to decreased material costs resulting partially from contractual discounts and a better product mix in 2001 and partially from write-offs of inventories in 2000. Cost of sales and services as a percentage of net sales decreased from 68.0% in 2000 to 60.4% in 2001.

Gross profit. Our gross profit increased 31.1% from US\$882.9 million in 2000 to US\$1,157.8 million in 2001. As a result, our gross margin increased from 32.0% in 2000 to 39.6% in 2001, primarily as a result of the reduction in cost of sales.

Operating expenses. Operating expenses increased 20.4% from US\$420.8 million in 2000 to US\$506.4 million in 2001. This increase was attributable primarily to an increase of 43.1% in research and development from US\$69.6 million in 2000 to US\$99.6 million in 2001, a 9.6% increase in selling expenses from US\$193.4 million in 2000 to US\$212.1 million in 2001, a 25.0% increase in general and administrative expenses from US\$96.6 million in 2000 to US\$120.8 million in 2001 and a 51.0% increase in other operating expenses, net from US\$19.5 million in 2000 to US\$29.5 million in 2001.

The increase in research and development is principally related to development of the new EMBRAER 170/190 jet family. The increase in selling expenses was directly attributable to the marketing campaign for the EMBRAER 170/190 jet family. In addition, we incurred expenses related to our expansion into new markets such as Asia and China. The increase in administrative expenses was partially due to the increase in technology expenses relating to the implementation of an enterprise resource planning system and to the hiring of new administrative personnel in order to accommodate the increased production schedule expected at that time. As a result of the September 11th terrorist attacks, some of our customers rescheduled deliveries. Although we implemented certain cost containment programs, including a reduction of workforce, these reductions were not fully implemented at the time that deliveries were rescheduled.

The increase in other operating expenses, net is primarily due to US\$7.9 million in engineering training and professional development expenses and a non-recurring expense of US\$4.5 million in restructuring costs in 2001 related to headcount reduction.

Operating expenses as a percentage of net sales increased from 15.3% in 2000 to 17.3% in 2001, primarily as a result of the increases in research and development expenses as well as selling, general and administrative expenses.

Interest income (expense). Interest income increased from interest expenses of US\$6.9 million in 2000 to interest income of US\$47.5 million in 2001, primarily due to a significant increase in our average cash and cash equivalent balances in the first three quarters of 2001.

Financial transaction gain (loss), net. Financial transaction loss, net increased from US\$24.6 million in 2000 to US\$148.6 million in 2001. These amounts reflect the restatement of non-U.S. dollar-denominated assets and liabilities into U.S. dollars. The increase from 2000 to 2001 is due to the increase in the rate of devaluation of *reais* against the U.S. dollar over net assets denominated in *reais*.

Other non-operating income (expense), net. Other non-operating income (expense), net decreased from an income of US\$6.0 million in 2000 to an expense of US\$8.4 million in 2001. The decrease in 2001 was primarily due to a gain of US\$12.9 million recognized in 2000 resulting from the sale of shares of our subsidiary ELEB-Embraer Liebherr Equipamentos do Brasil S.A. to Liebherr International AG.

Provision for income taxes. Our provision for income taxes increased from US\$117.4 million in 2000 to US\$218.4 million in 2001 mainly due to our higher taxable profits under the Brazilian Corporate Law financial statements as well as the fact that in 2000 our provision for income taxes was reduced by US\$27.5 million related to an adjustment of valuation allowance for deferred tax assets. Our effective tax rate in 2001 was 40.3% as compared to 26.9% in 2000, as compared to a statutory tax rate in each year of 34%. The difference between the statutory rate and the effective rates is due to differences in income before income taxes under U.S. GAAP and the taxable income calculated under the Brazilian Corporate Law.

In 2001, we recorded a gain of US\$5.4 million related to our implementation of FASB 133 in January 2001. As a result, we recognized a gain related to the adjustment of the value of certain of our derivative instruments to fair value. Losses related to these instruments were recognized prior to our adoption of FASB 133.

Net income. As a result of the foregoing factors, our net income increased 2.4% from US\$320.7 million in 2000 to US\$328.4 million in 2001. Net income remained relatively stable as a percentage of net sales. In 2000, net income was 11.6% of net sales as compared to 11.2% in 2001.

5B. Liquidity and Capital Resources

Our liquidity needs arise principally from research and development, capital expenditures, principal and interest payments on our debt, working capital requirements and distributions to shareholders. We generally rely on funds provided by operations, borrowings under our credit arrangements, cash contributions from risk-sharing partners, advance payments from customers and, to a lesser extent, capital increases to meet these needs. We believe that these sources of funds will be sufficient to fund our future liquidity needs, develop the EMBRAER 170/190 jet family, make other planned capital expenditures and pay dividends. However, our customers may reschedule deliveries, fail to exercise options or cancel firm orders as a result of the economic downturn and the financial volatility in the airline industry. In addition, our risk-sharing partners' cash contributions are refundable under certain limited circumstances and we may need to find replacement sources of capital.

Working Capital and Net Cash Provided by Operating Activities

We had a working capital surplus of US\$877.5 million at December 31, 2001 and US\$871.2 million at December 31, 2002. Working capital remained relatively flat. We had decreased inventories of US\$150.3 million as a result of the reduced production of the ERJ 145 regional jet family, partially offset by increased inventories for the EMBRAER 170/190 jet family. Offsetting this decrease was a US\$139.1 million increase in accounts receivable due primarily to our continuing to deliver aircraft to customers that had not yet finalized their financing arrangements. As of December 31, 2002, 68% of our short-term trade accounts receivable related to financing that had been approved by BNDES at that time and for which disbursements were pending and 23% of which related to financing that was being negotiated and finalized.

We generated net cash provided by operating activities of US\$507.7 million in 2002, as compared to net cash used in operating activities of US\$263.2 million in 2001 and net cash provided by operating activities of US\$1,120.0 million in 2000. Net cash provided by operating activities increased in 2002 despite the decrease in our income from operations principally due to decreases in inventories in 2002 and a significant increase in trade accounts receivable in 2001 following September 11th. Cash contributions from suppliers increased US\$91.8 million due to the increase in the aggregate development costs for EMBRAER 170/190 during the later stages of development. At December 31, 2002, advances from customers totaled US\$504.9 million, 81.1% of which represented current liabilities.

Cash Provided by (Used in) Financing Activities and Total Debt

Our net cash provided by (used in) financing activities decreased from net cash provided by financing activities of US\$98.4 million in 2001 to net cash used in financing activities of US\$399.4 million in 2002. The decrease was primarily due to reduced borrowings. Our net cash provided by (used in) financing activities increased from net cash used in financing activities of US\$130.4 million in 2000 to net cash provided in financing activities of US\$98.4 million in 2001.

We significantly extended the maturity profile of our debt in 2002. At December 31, 2002, we had total debt of US\$552.6 million under our financing arrangements described below, 55.8% of which consisted of long-term debt and 44.2% of which consisted of short-term debt. In comparison, we had total debt of US\$771.7 million at December 31, 2001 and US\$456.0 million at December 31, 2000, consisting of 31.8% and 20.0% of long-term debt. Our total debt decreased from 2001 to 2002 largely due to a reduced level of new borrowings.

Total debt consists of amounts recorded as loans on our balance sheet and excludes non-recourse debt associated with customer financing arrangements transacted through special purposes entities, or SPEs. In structured financings, an SPE purchases aircraft from us, pays us the full purchase price on delivery or at the conclusion of the sales financing structure, and leases the related aircraft to the ultimate customer. A third-party financial institution facilitates the financing of an aircraft purchase through an SPE, and a portion of the credit risk and the management responsibility associated with the SPE remain with that third party. Under U.S. GAAP, leasing transactions made through an SPE must be consolidated if the equity contribution of independent third parties is less than 3% of the fair value of the SPE's assets, as discussed in EITF 90-15. Some of the SPEs through which we sell aircraft were formed without any equity contribution and, therefore, are consolidated. We also have a temporary variable interest in other leasing transactions that are pending receipt of equity contributions and therefore, under FAS 144 adopted in 2002, are required to be consolidated.

The effect of consolidating these SPEs resulted in non-recourse debt at December 31, 2002, reflected as a separate line item on our balance sheets, of US\$941.9 million and collateralized accounts receivable of the same amount. We have no actual obligation for US\$803.5 million of this debt other than potentially under existing financial guarantees. The remaining US\$138.4 million of debt is recourse to us as a result of our guarantees of the temporary debt financing that is in place while equity contributions are pending. The non-recourse debt is collateralized by the collateralized accounts receivable and by the financed aircraft. These financing transactions do not materially affect our income statement and cash flow data since the terms of the leases and the loans are substantially the same. See Note 8 to our consolidated financial statements.

During 2002, British Airways returned to an SPE two ERJ 145s with a total outstanding amount of underlying debt of US\$22 million, which has been consolidated by us. These aircraft serve as collateral for the non-recourse debt and we have begun remarketing them. Until they are remarketed, we are making interest payments on the underlying debt under our financial guarantee obligations.

FASB Interpretation No. 46, issued in January 2003, will require us to re-evaluate our consolidation of all SPEs. See Recent Accounting Standards below for a further discussion of FASB Interpretation No. 46. See our discussion of these items in Notes 4, 8 and 37 to our consolidated financial statements.

Credit Facilities and Lines of Credit

Long-term facilities

We maintain credit facilities with BNDES primarily to fund development costs of the ERJ 145, of which US\$47.9 million was outstanding at December 31, 2002, and with FINEP primarily to fund development costs of the AL-X, of which US\$5.4 million was outstanding at December 31, 2002. Amounts borrowed from BNDES are secured by first, second and third mortgages on our properties in Brazil. The interest rates on these facilities are either fixed at 5.5% per annum or range from TJLP plus 3.0% to TJLP plus 5.5% per annum plus, for BNDES borrowings, we paid fees at the rate of 0.35% of the sales price of 420 ERJ 145s sold between January 1, 1997 and August 1, 2002.

We have a credit facility with the Tokyo Branch of The Chase Manhattan Bank under which we borrowed the Japanese yen equivalent of US\$150.0 million, principally to fund our purchase of aircraft component parts, of which US\$125.1 million remains outstanding. The interest rate under this facility is equal to the twelve-month Japanese interbank deposit rate, or JIBOR, plus 1.1% per annum. On September 20, 2002, we secured a US\$100.0 million credit facility with Mitsui & Co., Ltd. and borrowed the full amount available thereunder. This loan matures in 2009 and bears interest at an interest rate of LIBOR plus 2.2%. The facility is guaranteed by Unibanco União de Bancos Brasileiros SA. If we fail to maintain a minimum of 100 firm orders during the duration of the facility or fail to obtain certification of the EMBRAER 170 prior to December 2003, Mitsui & Co. Ltd has the right to declare all amounts outstanding under this facility due and payable. We also have US\$100.0 million credit facility with Santander Central Hispano Benelux S.A. to fund our purchases of wings and other equipment from Gamesa. As of December 31, 2002, US\$14.0 million was outstanding under this facility and we have additional availability of US\$86.0 million through December 2003. Amounts outstanding under this facility bear interest at a fixed rate of 4.49% per annum. We recently signed a credit agreement with Sumitomo Mitsui Banking Corp. and other lenders providing for a term loan of US\$200.0 million, at a rate of LIBOR plus 2.97% per annum, to purchase materials for the manufacture of the EMBRAER 170/190 jet family. We expect to borrow the full amount under this facility in early July and have entered into a swap transaction effectively converting the total debt to *real*-denominated CDI-based obligations.

We have various other loans and credit agreements with aggregate outstanding borrowings of US\$113.1 million at December 31, 2002. Each of our long-term financing arrangements includes customary covenants and restrictions, including those that require us to maintain defined debt liquidity and interest expense coverage ratios, with which we were in compliance at December 31, 2002 and none of which are expected to have a material effect on our business. See Note 20 to our consolidated financial statements for further information on these financing arrangements.

Short-term facilities

We obtain short-term financing primarily from Brazilian banks in the form of advances against exchange contracts that we enter into with those banks relating to payments we are entitled to receive within a period of not more than 360 days prior to delivery of aircraft. At December 31, 2002, we had US\$80.3 million outstanding under these arrangements.

In addition, we maintain short-term import financing lines of credit in Brazil. As of December 31, 2002, US\$32.8 million was outstanding under these lines of credit. We maintain subsidiary lines of credit from time to time to finance working capital requirements for these subsidiaries. At December 31, 2002, we had US\$33.1 million of outstanding debt under these lines of credit. See Note 20 to our consolidated financial statements for further information on our short-term financing arrangements.

Net Cash Used in Investing Activities

Our net cash used in investing activities was US\$200.8 million in 2002, compared to US\$275.2 million in 2001 and US\$104.4 million in 2000. The decrease in 2002 was mainly due a higher level of escrow deposits and compulsory loans made in 2001, primarily deposits collateralizing financing guarantees for certain aircraft sold, which increased US\$98.7 million in 2001 as compared to a US\$36.5 million increase in 2002.

Capital Expenditures

We recorded additions to property, plant and equipment of US\$127.8 million in 2002, US\$143.8 million in 2001 and US\$114.2 million in 2000. These expenditures related to construction of facilities, improvements to our plant and production facilities and modifications for the production of new aircraft models.

We expect our future capital expenditures to decrease in 2003 as we finalize construction and modifications of our facilities. We expect investments in property, plant and equipment to total approximately US\$58 million in 2003 and an additional US\$44 million in 2004, primarily related to the production of the EMBRAER 170/190 jet family, as well as our defense aircraft and corporate jets.

Capital Contributions and Issuances of Capital Stock

During 2002, we received capital contributions in the aggregate amount of US\$1.2 million, representing the issuance of preferred shares upon the exercise of options. During 2002, we issued 2,261,313 preferred shares at a weighted average exercise price of R\$1.75 per share. In addition, in June 2003, 360,000 preferred shares were issued upon the exercise of options at an exercise price of R\$1.25 per share.

Contractual Obligations and Commercial Commitments

The following table and discussion provide additional disclosure regarding our material contractual obligations and commercial commitments as of December 31, 2002.

Contractual Obligations	Total	Less than 1 year	1 - 3 years	3 - 5 years	More than 5 years
Loans	US\$541.2	US\$242.3	US\$173.0	US\$80.4	US\$45.5
Capital lease obligations	12.8	7.9	4.5	0.4	
Operating leases	11.4	2.2	3.4	1.1	4.7
Purchase obligations	327.7	327.7			
Other long-term liabilities	1,232.0	96.5	353.9	208.5	573.1
Total	US\$2,125.1	US\$676.6	US\$534.8	US\$290.4	US\$623.3

The above table does not reflect contractual commitments related to repurchase and trade-in options and financial and residual value guarantees discussed in Off-Balance Sheet Arrangements below. See Item 3D. Risk Factors Our aircraft sales are subject to cancellation provisions, repurchase and trade-in options and financial and residual value guarantees that may reduce our cash flow or require us to make significant cash disbursements in the future.

Purchase obligations consist of accounts payable to suppliers and insurance payables.

Other long-term liabilities include non-recourse debt in the total amount of US\$873.0 million that relates to obligations of SPEs. The above table does not reflect any information about our derivative instruments, which are discussed more fully in Item 11. Quantitative and Qualitative Disclosures About Market Risk.

Off-Balance Sheet Arrangements

We participate in a number of off-balance sheet arrangements, principally relating to repurchase and trade-in obligations, guarantees and variable interests in unconsolidated SPEs. We also have a number of swap transactions that are described in Item 11. Quantitative and Qualitative Disclosures about Market Risk.

Repurchase and Trade-in Obligations

We may have to repurchase a number of our aircraft. Under the relevant purchase contracts, the price per aircraft of any required repurchase is less than the original purchase price of the aircraft and less than our estimate at that time of the market value of the relevant aircraft type in future years (based on third party appraisals of aircraft valuations). If we are required to repurchase all of the relevant aircraft under our repurchase obligation, which covers the period from 2003 to 2007, we could be required to pay up to approximately US\$500 million for these aircraft. Based on our current estimates and third party appraisals, we believe that any repurchased aircraft could be sold without any material gain or loss.

At December 31, 2002, 34 of our regional jets were subject to trade-in options and additional aircraft may become subject to trade-in options upon delivery. These options provide that the trade-in price can be applied to the price of an upgraded model or any of our other aircraft. The trade-in price is determined in the manner discussed above for regional jets and as a percentage of original purchase price for our corporate jets. We may be required to

accept trade-ins at trade-in prices that are above the then-market price of the aircraft, which would result in financial loss for us when we resell the aircraft. Based on our current estimates and third party appraisals, we believe that any aircraft accepted for trade-in could be sold without any material gain or loss.

Financial and Residual Value Guarantees

We have guaranteed the financial performance of a portion of the financing for, and the residual value of, some of our aircraft that have already been delivered. Financial guarantees are provided to financing parties to support a portion of the payment obligations of purchasers of our aircraft under their financing arrangements to mitigate default-related losses. These guarantees are collateralized by the financed aircraft.

Assuming all customers supported by financial guarantees defaulted on their aircraft financing arrangements, we were required to pay the full aggregate amount of outstanding residual value guarantees and we were not able to sell or lease any of the aircraft to offset our obligations, our maximum exposure under these guarantees (less provisions and liabilities) would have been US\$1.4 billion as of December 31, 2002. We have deposited US\$187.4 million in escrow accounts to secure a portion of our financial guarantees. Based on current estimates, we believe that the proceeds from the sale or lease of the covered aircraft (based on resale value as of December 31, 2002) and from other offsetting collections would exceed our exposure by US\$326 million.

Our residual value guarantees typically ensure that in the 15th year after delivery, the relevant aircraft will have a residual market value of 10% to 27% of the original sale price. In the event of a decrease in the market value of the underlying aircraft, we will bear the difference between the then market value of the aircraft and the guaranteed residual value. Our exposure is mitigated by the fact that the guaranteed party, in order to benefit from the guarantee, must make the aircraft meet specific return conditions.

Variable Interests in Unconsolidated Entities

We are currently assessing the application of FIN 46 as it relates to our variable interests in unconsolidated SPEs. As discussed above, some of our sales transactions are structured financings through which an SPE purchases the aircraft, pays us the full purchase price and leases the related aircraft to the ultimate customer. Our variable interests in these SPEs typically include financial guarantees in favor of the third party financial institution or equity investors. Our exposure related to unconsolidated SPEs is included in the above amounts. Upon effectiveness of FIN 46, discussed below, we may consolidate additional SPE financing transactions which would result in additional non-recourse debt and collateralized accounts receivable on our balance sheet.

We continually re-evaluate our risk under our guarantees and repurchase and trade-in obligations based on a number of factors, including the estimated future market value of our aircraft based on third party appraisals, including information developed from the sale or lease of similar aircraft in the secondary market, and the credit rating of customers. See Note 37 to our consolidated financial statements for a further discussion of these off-balance sheet arrangements.

Recent Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board, or FASB, issued Statement of Financial Accounting Standards, or SFAS, No. 143, Accounting for Asset Retirement Obligations, which is effective as of January 1, 2003. SFAS No. 143 addresses financial and reporting for obligations associated with the retirement of tangible long-lived assets and the associated retirement costs. We have determined that the implementation of this standard will not have a material effect on our consolidated financial statements.

In July 2002, the FASB issued SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities. This standard requires costs associated with exit or disposal activities to be recognized when they are incurred. The requirements of SFAS No. 146 apply prospectively to activities that are initiated after December 31, 2002, and, consequently, we cannot reasonably estimate the impact of adopting these new rules until and unless we undertake the relevant activities in the future.

In November 2002, the FASB issued Interpretation No. 45, or FIN 45, Guarantors Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of the Indebtedness of Others, which clarifies the requirements of SFAS No. 5, Accounting for Contingencies, relating to a guarantors accounting for

and disclosure of certain guarantees issued. FIN 45 requires enhanced disclosures for certain guarantees. It will also require certain guarantees that are issued or modified after December 31, 2002, including certain third-party guarantees, to be initially recorded on the balance sheet at fair value. For guarantees issued before December 31, 2002, liabilities are recorded when and if payments become probable and estimable. We expect FIN 45 to have the general effect of delaying recognition of a certain portion of the revenue for product sales that are accompanied by certain third-party guarantees. The financial statement recognition provisions are effective prospectively, and we cannot reasonably estimate the impact of adopting FIN 45 until guarantees are issued or modified in future periods, at which time their results will be initially reported in our financial statements. See Note 37 to our consolidated financial statements for more information on our guarantees.

In January 2003, the FASB issued Interpretation No. 46, or FIN 46, Consolidation of Variable Interest Entities, which clarifies the application of Accounting Research Bulletin No. 51, Consolidated Financial Statements, relating to the consolidation of certain entities. First, FIN 46 will require identification of our participation in variable interest entities, or VIE, which are defined as entities with a level of invested equity that is not sufficient to fund future activities to permit them to operate on a stand-alone basis, or whose equity holders lack certain characteristics of a controlling financial interest. For entities identified as VIE, FIN 46 sets forth a model to evaluate potential consolidation based on an assessment of which party to the VIE, if any, bears a majority of the exposure to its expected losses, or stands to gain from a majority of its expected returns. FIN 46 also sets forth certain disclosures regarding interests in VIE that are deemed significant, even if consolidation is not required. We are currently assessing the application of FIN 46 as it relates to our variable interests. See Note 37 to our consolidated financial statements.

5C. Research and Development

We incur research and development costs related to our aircraft and aircraft components. We also incur research and development costs that are not associated with the development of any particular aircraft. Such costs include the implementation of quality assurance initiatives, production line productivity improvements and studies to determine the latest developments in technology and quality standards. The research and development costs incurred by Embraer are divided into two categories, research and development expense and additions to fixed assets. The research and development expense is the cost actually associated with the design and development of the aircraft less amounts earned from cash contribution from risk-sharing partners based on meeting performance milestones. Under U.S. GAAP, these costs are expensed in the year in which they are incurred. Additions to fixed assets relate solely to specialized equipment built by us and required for the project. These costs are treated as additions to property, plant and equipment.

We invest significantly in the development of new projects. Total research and development expenses for 2000, 2001 and 2002 were US\$69.6 million, US\$99.6 million and US\$158.5 million, respectively, net of cash contributions provided by risk-sharing partners. We estimate that our research and development costs for 2003 will be approximately US\$167.0 million. We do not record an expense for research and development of defense programs as they are funded by the Brazilian government and other government customers. Most of our research and development expenses are associated with a particular program, whether regional, corporate or defense.

We receive additional funds from risk-sharing partners to fund our cash costs for our commercial research and development. In addition, the Brazilian and other governments fund substantially all of our defense research and development costs under long-term development contracts.

5D. Trend Information

The following table summarizes our regional aircraft sales order book at June 30, 2003. Our total backlog at that date, including corporate jets and defense aircraft, was US\$10.3 billion.

	<u>Firm Orders</u>	<u>Options</u>	<u>Deliveries</u>	<u>Firm Order Backlog</u>
In the Regional Market				
EMB 120 Brasília	352		352	
ERJ 145	581	434	502	79
ERJ 135	121	6	100	21
ERJ 140	174	45	68	106
EMBRAER 170	119	157		119
EMBRAER 190	110	120		110
EMBRAER 195	15	32		15

For additional information regarding trends in our business, see Item 4B. Business Overview Business Strategies and Item 5A. Operating Results. For risks affecting our business, see Item 3D. Risk Factors.

ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES**6A. Directors and Senior Management**

We are managed by our *Conselho de Administração*, or board of directors, composed of at least nine and at most eighteen members, and our *Diretoria*, or committee of officers, composed of at least four members (each an executive officer). We have a permanent *Conselho Fiscal*, or audit board, which is composed of five members.

Board of Directors

Our board of directors ordinarily meets four times a year and extraordinarily when called by the chairman or by the majority of members of the board. It has responsibility, among other things, for establishing our general business policies and for electing our executive officers and supervising their management.

Our bylaws provide that the Chief Executive Officer of Embraer is automatically a member of the board of directors. As a result, Maurício Novis Botelho, currently President and Chief Executive Officer of Embraer, is a member of the board of directors. Our controlling shareholders, Cia. Bozano, PREVI and SISTEL, have entered into a shareholders' agreement which provides that when they appoint members of our board of directors at shareholders' meetings, they will each appoint two representatives (and alternates), and together they will vote to elect two representatives (and alternates) of the European Aerospace and Defense Group and one representative (and alternate) of the Brazilian government. This representative of the Brazilian government is in addition to the representative that the Brazilian government is entitled to appoint directly. See Item 7A. Major Shareholders' Voting Rights Shareholders' Agreement for more information on the shareholders' agreement. In addition, our bylaws provide that our employees are entitled to two representatives (and alternates) on our board of directors, who are elected at the annual shareholders' meeting.

All members of the board of directors serve three-year terms. The terms of all current members expire in April 2004. Set forth below are the names, ages, positions and brief biographical descriptions of the members of the board of directors at June 16, 2003.

Name	Age	Position	Year First Elected
Carlyle Wilson	74	Chairman of the Board of Directors	2000
Nélio Henriques Lima	51	Deputy-Chairman of the Board of Directors	2001
Maurício Novis Botelho	60	President and Chief Executive Officer	2000
Vitor Sarquis Hallack	50	Member of the Board of Directors	1995
Juarez Martinho Quadros do Nascimento	59	Member of the Board of Directors	1998
Fernando Antônio Pimentel de Melo	49	Member of the Board of Directors	2000
Luiz Felipe P. Lampreia	61	Member of the Board of Directors	2001
Reginaldo dos Santos	61	Member of the Board of Directors	2001
Paulo Cesar de Souza Lucas	43	Member of the Board of Directors	1999
Mario Hipólito Silva	38	Member of the Board of Directors	2001
Dietrich Russell	61	Member of the Board of Directors	2000
Isaac Marcel Picciotto	59	Member of the Board of Directors	2003
Henrique Pizzolato	50	Member of the Board of Directors	2003

Carlyle Wilson. Mr. Wilson has been with the Bozano group since 1972. Mr. Wilson is an executive director of Cia. Bozano and a board member of Bozano Holdings Ltd. Since 1992, Mr. Wilson has been a board member of Berneck Aglomerados, a wood fiber-board manufacturing company. In addition, since 1980, Mr. Wilson has been a board member of Bozano, Simonsen Centros Comerciais S.A., a shopping center administration company, and since 1986 has been a board member of GD Empreendimentos Imobiliários S.A., a real estate company. From January 1995 to January 2000, Mr. Wilson was an alternate board member of Embraer. Mr. Wilson is a representative of Cia. Bozano, and his business address is Rua Visconde de Ouro Preto, 5, 10th floor, 22250-180 Rio de Janeiro, RJ, Brazil.

Nélio Henriques Lima. Mr. Lima has worked for Banco do Brasil and PREVI since 1974, having held several positions. Since January 1999, he has been the Executive Superintendent of PREVI. From January 1995 to January 1997, he was the operations manager of PREVI, and from January 1997 to January 1999, he was the executive manager of PREVI. Mr. Lima was a member of the audit committee of La Fonte Participações S.A., a holding company, and Seguradora Brasileira de Crédito a Exportação S.A., an insurance company, and a member of the board of directors of Organização Social Bioamazônia, a biotechnology company, from January 1999 to December 1999. He was also a member of the board of directors of Tele Norte Leste Participações S.A., a telecommunications company, from September 2000 to April 2001. Mr. Lima is a representative of PREVI, and his business address is Praia de Botafogo, 501, 4th floor, 22250-040 Rio de Janeiro, RJ, Brazil.

Maurício Novis Botelho. Mr. Botelho has been President and Chief Executive Officer of Embraer since September 1995, as well as an executive officer and/or chairman of the board of several of Embraer's subsidiaries. Mr. Botelho served as chief executive officer of OTL Odebrecht Automação & Telecomunicações Ltda., also known as OTL and later named Stelar Telecom, a telecommunications company, from 1988 to 1995. He also served as chief executive officer of CMW Equipamentos S.A., or CMW, an industrial automation company, from 1985 to 1995. He was also the chief executive officer of STL - Engenharia de Sistemas Ltda., also known as STL, a project engineering company, from 1985 to 1995, a partner in Soluções Integradas PROLAN Ltda., also known as PROLAN, a corporate network company, from 1994 to 1995, and executive vice-president of TENENGE Técnica Nacional de Engenharia Ltda., or TENENGE, a construction company, during 1992. During 1995, Mr. Botelho was an executive officer of Cia. Bozano. Mr. Botelho's business address is the address of our principal executive offices.

Vitor Sarquis Hallack. Mr. Hallack has been with the Bozano group since 1993. He is an executive director of Cia. Bozano and a board member and an executive director of Bozano Holdings Ltd. He was an executive officer of Banco Bozano Simonsen S.A. from April 1998 to May 2000. Mr. Hallack was the chief financial officer of Companhia Siderúrgica Paulista COSIPA from September 1993 to December 1994. Prior to 1993, Mr. Hallack was the chief financial officer of Companhia Vale do Rio Doce, a mining company. Mr. Hallack

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is a representative of Cia. Bozano, and his business address is Rua Visconde de Ouro Preto, 5, 10th floor, 22250-180 Rio de Janeiro, RJ, Brazil.

Juarez Martinho Quadros do Nascimento. Mr. Nascimento was the Minister of Communications of the Brazilian government from April 2002 to December 2002. From 1997 to April 2002, he was the executive secretary of the Communications Ministry of the Brazilian government and the chairman of the board of directors of Telecomunicações Brasileiras S.A. Telebrás, a telecommunications company, also known as Telebrás. Mr. Nascimento was the secretary of inspection and concession of the Communications Ministry from 1995 to 1997. From 1990 to 1995, he was an officer of Telebrás, ending his tenure there during 1995 as the assistant to the deputy chief executive officer and the public services department officer. Mr. Nascimento is a representative of SISTEL, and his business address is SCN Quadra 01, Suite 308, 70711-000, Brasília, DF, Brazil.

Fernando Antônio Pimentel de Melo. Mr. Melo has been the Officer of Social Security of SISTEL since 1991 and the Superintendent Officer of SISTEL since 1999. He has also been a member of the board of directors of Companhia de Aços Especiais Itabira Acesita, a steel company, and of Telesp Participações S/A since December 1999, Amerigel S.A. since April 1999, and Telet S.A. since April 2000, all telecommunications companies. Mr. Melo was also the vice-president of SINDAPP Sindicato Nacional das Entidades de Previdência Privada, having been elected in December 1998 for the term of three years. He is a representative of SISTEL, and his business address is SEP Sul 702/902, Conj. B, Bloco A, Ed. Gal. Alencastro, 4th floor, 70390-025 Brasília, DF, Brazil.

Luiz Felipe P. Lampreia. Mr. Lampreia was the Foreign Relations Minister of the Brazilian government from January 1995 to January 2001. Mr. Lampreia has held several positions in the Brazilian government, both in Brazil and abroad, since 1963. From 1992 to 1993, he was the Secretary General of Foreign Relations of the Brazilian government. From 1993 to 1994, Mr. Lampreia was Brazil's ambassador to various international organizations located in Geneva, and participated in the creation of the WTO. Mr. Lampreia is a representative of the Brazilian government and was appointed by our controlling shareholders. His business address is Av. Ataulfo de Paiva, 341, Suite 605, 22440-030 Rio de Janeiro, RJ, Brazil.

Reginaldo dos Santos. Mr. Santos has been a Lieutenant-Brigadier in the Brazilian Air Force since March 2000 and is currently the General Director of the Department of Research and Development of the Brazilian Air Force. Mr. Santos has held various positions in the Brazilian armed forces since 1958, when he began his military career. Mr. Santos is a representative of the Brazilian government and was appointed by our controlling shareholders. His business address is Air Force Command, Department of Research and Development, Esplanada dos Ministérios, Bloco M, 3rd floor, 70045-900 Brasília, DF, Brazil.

Paulo Cesar de Souza Lucas. Mr. Lucas has participated in our strategic planning division since 1998 and was the coordinator of Embraer's implementation of the modernization and cost-reduction strategy from 1990 to 1996. Mr. Lucas has been working at Embraer for more than 16 years and is a representative of our employees. Mr. Lucas's business address is the address of our principal executive offices.

Mario Hipólito Silva. Mr. Silva has been an employee in our production line since 1996 and a union representative for our metallurgical employees since 1997. He is a representative of our employees. Mr. Silva's business address is the address of our principal executive offices.

Dietrich Russell. Mr. Russell has been the Executive Vice President of the Aeronautics Division for EADS since July 2000. From 1972 until 1995, Mr. Russell worked for the Mannesmann Group in various capacities and divisions, culminating in his service as chairman of the board of management of Mannesmann Anlagenbau AG. Mr. Russell was also a member of the board of management of Daimler-Benz Aerospace AG, currently known as EADS, and was responsible for the Aircraft Group between October 1995 and April 1997. Thereafter, he was responsible for the Civil Aircraft and Helicopters Group of Daimler-Benz Aerospace board of management until March 1998. In April 1998, Mr. Russell was appointed chief operating officer of the Airbus Industrie division of EADS, a position he held until July 2000. Mr. Russell is a representative of the European Aerospace and Defense Group, and his business address is 1, Avenue Didier Daurat, 31700 Blagnac, France.

Isaac Marcel de Piccioto. Mr. Piccioto has been the Corporate Vice President Strategy for the Business Group Airborne Systems at Thales™ since 2001. Prior to that, he occupied several management positions at Thales™ from 1990 to 2000. He was Vice President International Business Development at Philips from 1988 to 1990. From 1974 to 1986, Mr. Piccioto was Corporate Vice President International Marketing, Export Sales Director, Director for Europe, North America and Asia Pacific at Matra. Mr. Piccioto is a representative of the European Aerospace and Defense Group and his business address is 2, Avenue Gay Lussac, 78851 Elancourt Cedex, France.

Henrique Pizzolato. Mr. Pizzolato has been the Marketing and Communications Officer for the Banco do Brasil since February 2003. From June 1998 to May 2002, he was the Director of Social Security at PREVI. He was also a member of the Board of Banco do Brasil from 1993 to 1996. In addition, Mr. Pizzolato was a member of the board of directors of Telecentrosul and Brasil Telecom, telecommunications companies, from 1999 to 2000. He is a representative of PREVI and his business address is SBS Quadro 1, Bloco C, Loto 32, 70073-93 Brasilia, DF, Brazil.

Executive Officers

Our executive officers are responsible for our day-to-day management. The executive officers have individual responsibilities established by our bylaws and by the board of directors. The business address of each of our executive officers is the address of our principal executive offices.

The executive officers are elected by the board of directors for a three-year term, and any executive officer may be removed by the board of directors before the expiration of his term. Set forth below are the names, ages, positions and brief biographical descriptions of our executive officers at June 16, 2003.

Name	Age	Position	Year First Elected
Maurício Novis Botelho	60	President and Chief Executive Officer	1995
Antonio Luiz Pizarro Manso	58	Executive Vice-President Corporate and Chief Financial Officer	1995
Satoshi Yokota	62	Executive Vice-President-Development and Industry	1997
Frederico Pinheiro Fleury Curado	41	Executive Vice-President-Civil Aircraft	1997
Romualdo Monteiro de Barros	54	Executive Vice-President-Defense Market	1997
Horácio Aragonés Forjaz	51	Executive Vice-President-Corporate Communications	1998
Carlos Rocha Villela	47	Vice-President and General Counsel	1999

Maurício Novis Botelho. For a biographical description of Mr. Botelho, please see Board of Directors.

Antonio Luiz Pizarro Manso. Mr. Manso has been Executive Vice-President Corporate since 2001 and Chief Financial Officer of Embraer since 1995. Mr. Manso is also a director and/or president of several of Embraer's subsidiaries. Mr. Manso was the administrative and financial officer of STL from 1986 to 1995 and of CMW from 1986 to 1995 and served as member of the board of directors of CMW during 1995. He was also the chief financial officer of OTL from 1989 to 1995, the financial officer of TENENGE during 1992 and the chief financial officer of PROLAN from 1994 to 1995.

Satoshi Yokota. Prior to becoming Executive Vice-President-Development and Industry of Embraer in 1997, Mr. Yokota held several other positions at Embraer, including Programs and Commercial Contracts Officer during 1995 and 1996 and Programs Officer from 1992 to 1995. Mr. Yokota is also the chairman of the board of directors of ELEB, one of Embraer's subsidiaries.

Frederico Pinheiro Fleury Curado. Prior to becoming Executive Vice-President-Civil Aircraft of Embraer in 1998, Mr. Curado was our Executive Vice-President Planning and Organizational Development from 1997 to August 1998. Prior to that, he held several different positions at Embraer in the areas of manufacturing,

procurement, information technology, contracts and sales. Mr. Curado is also a director and/or secretary of several of Embraer's subsidiaries.

Romualdo Monteiro de Barros. Prior to becoming Executive Vice-President-Defense Market of Embraer in 1997, Mr. Barros was the officer responsible for business development at OTL, later named Stelar Telecom, from 1994 to 1997.

Horácio Aragonés Forjaz. Prior to becoming Executive Vice-President-Corporate Communications of Embraer in 2001, Mr. Forjaz was Executive Vice-President Planning and Organizational Development of Embraer from 1998 to 2001, and prior to 1998, he was our engineering officer. From 1995 to 1997, Mr. Forjaz was the operational director of Compsis Computadores e Sistemas Ltda., a systems engineering and software company, and from 1975 to 1995, he held several different positions at Embraer in the areas of engineering and systems design.

Carlos Rocha Villela. Prior to becoming Vice-President and General Counsel of Embraer in 1999, Mr. Villela was the general counsel of Odebrecht Química S.A., a chemical company, since 1994. Mr. Villela is also a director, executive officer and/or secretary of several of Embraer's subsidiaries.

6B. Compensation

For the fiscal year ended December 31, 2002, the aggregate compensation (including benefits in kind granted) that we paid to members of the board of directors and the executive officers for services in all capacities was approximately US\$6.2 million. In addition, in 2002, the executive officers received pension benefits, instituted in January 1999, of approximately US\$64,173 as of December 31, 2002. The members of our board of directors did not receive any such benefits. The board members and executive officers did not receive any compensation (including benefits in kind) from any of our subsidiaries. At December 31, 2002, none of the board members or executive officers had any financial or other interests in any transaction involving Embraer which was not in the ordinary course of our business.

In addition, at June 16, 2003, the board members and executive officers owned an aggregate of 19 common shares and 3,606,780 preferred shares.

Stock Option Plan

At a special shareholders' meeting held on April 17, 1998, we approved a stock option plan for management and employees, including those of our subsidiaries, subject to restrictions based on continuous employment with us for at least two years.

Under the terms of the plan, we were authorized to grant options to purchase up to 25,000,000 preferred shares over the five-year period from the date of the first grant. As of the end of this five-year period, we had granted options for an aggregate of 19,665,000 preferred shares at a weighted average exercise price of R\$9.17 per share. The options granted to each employee will vest as follows: 30% after three years from the date granted, an additional 30% after four years and the remaining 40% after five years. Employees may exercise their options for up to seven years from the date they are granted. As of June 16, 2003, 7,556,313 of the total options granted had been exercised. Of the total number of options granted, options to purchase an aggregate of 7,200,000 preferred shares have been granted to our executive officers at a weighted average exercise price of R\$5.30 per share, of which 4,445,000 were exercised during the period from January 1, 2001 through June 16, 2003.

Profit Sharing Plan

Pursuant to Brazilian federal law, companies operating in Brazil are required to share profits with employees beginning from and after fiscal year 1996. However, we understand that no government regulation currently exists for determining how the profits should be distributed. Prior to 1998, we did not have a profit sharing plan. However, in light of our continuing financial recovery since then, we implemented a profit sharing plan in 1998 that ties employee profit sharing to dividend payments.

Every time we pay dividends to our shareholders, we also pay a profit sharing participation of 25% of the amount of the dividend payment to employees who have achieved goals established at the beginning of the year. Under the plan, we may pay additional amounts of up to an additional 5% of such dividend payment to exceptional employees, on a discretionary basis. We believe that this policy encourages individual employees to meet our production goals.

For the 2000 fiscal year, we distributed US\$41.8 million to employees, for the 2001 fiscal year, we distributed US\$43.7 million to employees and for the 2002 fiscal year, we distributed US\$25.2 million to employees.

6C. Board Practices

All members of our board of directors serve three-year terms and the terms of all current members expire in April 2004. See Directors and Senior Management Board of Directors for the year each of the members of our board of directors was first elected.

The executive officers are elected by the board of directors for a three-year term, and any executive officer may be removed by the board of directors before the expiration of his term. See Directors and Senior Management Executive Officers for the year each of our executive officers was first elected.

None of our directors or executive officers is party to an employment contract providing for benefits upon termination of employment.

Audit Board

Under the Brazilian Corporate Law, the *conselho fiscal* (audit board) is a corporate body independent of management and a company's external auditors. A Brazilian audit board is not equivalent to, or comparable with, a U.S. audit committee. The primary responsibility of the audit board is to review management's activities and the financial statements, and to report its findings to the shareholders. Under the Brazilian Corporate Law, the audit board may not contain members that are on the board of directors, on the executive committee, our employees, employees of a controlled company or of a company of this group, or a spouse or relative of any member of our management. In addition, the Brazilian Corporate Law requires the audit board members to receive as remuneration at least 10% of the average amount paid to each executive officer. The Brazilian Corporate Law requires an audit board to be composed of a minimum of three and a maximum of five members and their respective alternates.

We have a permanent audit board whose members are elected at the annual shareholders' meeting, with terms lasting until the next annual shareholders' meeting after their election. Under the Brazilian Corporate Law, holders of preferred shares have the right to elect separately one member of the audit board. Also, under the Brazilian Corporate Law, minority groups of shareholders that hold at least 10% of the voting shares also have the right to elect separately one member of the audit board. In any event, however, the common shareholders have the right to elect the majority of the members of the audit board. Set forth below are the names and positions of the members of our audit board and their respective alternates.

Name	Position	Year First Elected
Luiz Tacca Júnior	Effective member	1995
Robson de Araújo Jorge	Alternate	2000
Carlos Alberto de Castro Monteiro	Effective member	2001
Tarcísio Luiz Silva Fontenele	Alternate	2001
José Mauro Laxe Vilela	Effective member	2003
Alberto Carlos Monteiro dos Anjos	Alternate	2003
Paulo Oscar França	Effective member	2003
Ernesto Francisco Magdalena	Alternate	2003
Celene Carvalho de Jesus	Effective member	2003
Nilo Ribeiro Calvalcanti	Alternate	2003

6D. Employees

We employed a total of 10,334, 11,048 and 12,227 people at December 31, 2000, 2001 and 2002, respectively. Approximately 94.1% of our workforce is employed in Brazil. Of the total workforce at December 31, 2002, 47.8% are directly involved in the production process, 22.3% are engaged in research and development, 7.8% are administrative employees involved in support of the production process and 22.1% are other administrative employees. Most of our technical staff is trained at leading Brazilian engineering schools, including the *Instituto Tecnológico Aeronáutico*, known as the ITA, located in São José dos Campos. A small percentage of our employees belong to one of two different labor unions, the *Sindicato dos Metalúrgicos* (Union of Metallurgical Workers) or the *Sindicato dos Engenheiros do Estado de São Paulo* (Union of Engineers of the State of São Paulo). Overall, union membership as a percentage of total workforce has declined significantly in past years. At December 31, 2002, approximately 80.5% of our employees were non-union. We believe that relations with our employees are good.

We actively support the training and professional development of our employees. We have established a program at our new facility in São José dos Campos to provide newly graduated engineers with specialized training in aerospace engineering. In addition, we provide a masters in business administration course for our administrative personnel at our executive offices, conducted by *Fundação Getúlio Vargas*, a business administration university in São Paulo.

6E. Share Ownership

At June 16, 2003, the board members and executive officers owned an aggregate of 19 common shares and 3,606,780 preferred shares. None of the officers or directors individually own more than 1% of the outstanding common shares or preferred shares. As of June 16, 2003, our executive officers also owned options to purchase an aggregate of 2,755,000 preferred shares at per-share purchase prices ranging from R\$1.65 to R\$23.00. As of the same date, none of our directors owned any options to purchase shares of common or preferred stock.

See Compensation Stock Option Plan for a description of our stock option plan applicable to our management and employees, including those of our subsidiaries.

ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

7A. Major Shareholders

We have total authorized capital of 1,500,000,000 shares, with a total aggregate of 713,334,355 shares issued and outstanding at June 16, 2003. Of this total, 242,544,448 are common shares (including one special golden share held by the Brazilian government) and 470,789,907 are non-voting preferred shares. The following table sets forth share ownership information for each of our shareholders that beneficially owns 5% or more of any class of our equity securities and for our executive officers and board members at June 16, 2003, including 2,997,545 preferred shares underlying the options exercisable within 60 days of the date of this annual report.

	Common Shares		Preferred Shares		Total shares	
	Shares	(%)	Shares	(%)	Shares	(%)
PREVI(1)	57,594,479	23.8	60,872,078	12.9	118,466,557	16.5
SISTEL(2)	48,508,890	20.0	5,233,725	1.1	53,742,615	7.5
Cia. Bozano(3)(4)	48,509,220	20.0	18,786,588	4.0	67,295,808	9.4
Bozano Holdings Ltd.(3)(4)			18,896,920	4.0	18,896,920	2.6
BNDESPAR(5)	3,734,893	1.5	46,929,918	9.9	50,664,811	7.1
Dassault Aviation(6)	13,744,186	5.7	1,953,132	**	15,697,318	2.2
Thales TM (6)	13,744,186	5.7	1,953,132	**	15,697,318	2.2
EADS(6)	13,744,186	5.7	1,953,132	**	15,697,318	2.2
SNECMA(6)	7,276,332	3.0	1,034,010	**	8,310,342	1.2
BB Banco de Investimento, S.A.(7)	3,015,562	1.2	2,890,909	**	5,906,471	**
União Federal/Brazilian Government(8)	1,850,495	**	499,415	**	2,349,910	**
Officers and directors as a group(9)	19	**	4,161,780	**	4,161,799	**
Other(10)	30,822,000	12.7	308,622,713	65.1	339,457,502	47.4
Total	242,544,448		473,787,452		716,344,689	
Percentage of total shares outstanding		33.9		66.1		100.0

** Less than 1%.

- (1) Banco do Brasil Employee Pension Fund, also known as PREVI, was founded in 1904 as a pension fund for the employees of Banco do Brasil S.A, which is controlled by the Brazilian government.
- (2) SISTEL Social Security Foundation, also known as SISTEL, was founded in 1977 as part of the Telebrás system, which, prior to its recent privatization, consisted of the Brazilian government-owned telecommunications companies.
- (3) The above table does not reflect any exchangeable notes issued by BNDES that may be currently owned by Bozano Holdings Ltd.
- (4) Cia. Bozano and Bozano Holdings Ltd. are owned and controlled by Julio Bozano. All preferred shares owned by Cia. Bozano and Bozano Holdings Ltd. have been pledged in favor of Banco Santander Central Hispano, S.A. in connection with its acquisition from Cia. Bozano of substantially all of the capital stock of Banco Meridional S.A.
- (5) BNDESPAR is a wholly owned subsidiary of Banco Nacional de Desenvolvimento Econômico e Social BNDES, the government-owned national development bank of Brazil
- (6) Member of the European Aerospace and Defense Group.
- (7) BB Banco de Investimento, S.A. is an affiliate of the Brazilian government-owned Banco do Brasil S.A.

- (8) The Brazilian government also holds the golden share.
- (9) The number of preferred shares includes 555,000 preferred shares underlying options which are exercisable within 60 days of the date of this annual report.
- (10) The number of preferred shares includes 2,442,545 preferred shares underlying options which are exercisable within 60 days of the date of this annual report.

Other than as discussed in Item 4. Information on the Company History and Development of the Company, there have been no significant changes in percentage ownership by any major shareholder in the past three years.

On June 16, 2003, we had 25,219 holders, either directly or through ADSs, of preferred shares, and 4,167 holders of record of common shares. On June 16, 2003, an aggregate of 209,410,561 preferred shares were held, either directly or through ADSs, by 188 record holders, including DTC, in the United States.

Voting Rights

Voting Rights of the Common Shares

Each common share entitles the holder thereof to one vote at our annual and special shareholders meetings.

Shareholders Agreement

Each of Cia. Bozano, PREVI and SISTEL, our controlling shareholders, has agreed to comply with the terms of a shareholders agreement entered into on July 24, 1997, as amended, which governs matters relating to their equity ownership of Embraer for a ten-year term and can be successively renewed for five-year terms. According to the shareholders agreement, when appointing the members of our board of directors at shareholders meetings, our controlling shareholders have agreed to appoint two representatives (and alternates) of each one of the controlling shareholders and to vote together to elect two representatives (and alternates) of the European Aerospace and Defense Group and one representative (and alternate) of the Brazilian government.

Our controlling shareholders have also agreed in the shareholders agreement that the Chairman of our board of directors will be chosen by agreement among them every 18 months and that the Chairman shall be one of their representatives. In the event that our controlling shareholders cannot agree on who will be the Chairman of the board, the order in which their representatives will take turns as Chairman shall be decided by lottery.

In accordance with the shareholders agreement, our controlling shareholders may not sell, assign, contribute as capital, pledge or in any other way transfer, dispose of or create a lien on the common shares tied to control of Embraer held by them, except as provided for in the shareholders agreement or if the transaction is previously authorized in writing by the other parties. According to the shareholders agreement, if any controlling shareholder wishes to sell, assign, transfer or in any way dispose of part or all of its common shares tied to control of Embraer, whether or not together with other shares of Embraer of any kind or class, the other controlling shareholders shall have a right of first refusal to acquire the shares being offered.

The shareholders agreement provides that our controlling shareholders shall meet or shall manifest their position by fax or any other electronic means in connection with any shareholders meeting or meeting of the board of directors, as the case may be, when any of the following matters involving us or any of our subsidiaries shall be decided:

amendment to the bylaws, except when required by law;

increase of capital by subscription, creation of a new class of shares, change in the characteristics of the existing shares or reduction of capital;

issuance of debentures convertible into shares, subscription warrants and options for the purchase of shares;

merger or spin-off;

liquidation, dissolution and voluntary acts of financial reorganization;

acquisition or sale of participation in other companies, except special purpose companies that are necessary or desirable in our business of selling aircraft;

establishment of a dividend policy which differs from that provided for in the bylaws as the minimum dividend;

approval of new investments and/or financing and/or sale of investments in an amount higher than that agreed upon by the parties from time to time;

approval and change of long-term business plans;

determination of the remuneration of, and participation in our profits by, our managers;

selection, hiring and firing of our executive officers;

choosing our external auditors;

granting liens on, or guarantees in favor of, real or personal property or obligations of management except for those necessary or desirable in our business of manufacturing and selling aircraft;

sale of a substantial part of our permanent assets; and

use of profits.

The shareholders' agreement also states that our controlling shareholders will vote in favor of maintaining and increasing our strategic relationship with the Brazilian Armed Forces, particularly with the Brazilian Air Force, in order to assure that we continue to prioritize our relationship with Brazil, without prejudice to our other corporate interests.

Golden Share

The golden share is held by the Federative Republic of Brazil. The golden share is entitled to the same voting rights as the holders of common shares. In addition, the golden share entitles the holder thereof to veto rights over the following corporate actions:

change of our name and corporate purpose;

amendment to and/or extension of our logo;

creation and/or alteration of military programs (whether or not involving Brazil);

third party training in technology for military programs;

discontinuance of the supply of military airplane maintenance and replacement parts;

transfer of share control; and

any change to the list of corporate actions over which the golden share carries veto power, to the structure and composition of the board of directors, and to the rights conferred to the golden share.

Voting Rights of the Preferred Shares

Preferred shares do not entitle the holder to vote except as set forth below. However, holders of preferred shares are entitled to attend meetings of shareholders and to participate in the discussion of matters submitted for consideration.

The Brazilian Corporate Law requires that non-voting preferred shares which are entitled to receive fixed or minimum dividends shall acquire voting rights in the event a company fails to pay, from one to three consecutive fiscal years as established in the bylaws, the fixed or minimum dividend to which such shares are entitled. Because our preferred shares are not entitled to fixed or minimum dividends, they cannot acquire voting rights under this rule. However, our preferred shares are entitled to their share of any mandatory dividends distributions that we

make. See Item 8A. Consolidated Statements and Other Financial Information Dividends and Dividend Policy Amounts Available for Distribution.

Any change in the preference or rights of preferred shares, or the creation of a class of shares having priority or preference over preferred shares, requires approval by at least half of all outstanding voting shares and either (1) prior approval of holders of a majority of the outstanding preferred shares at a special meeting of holders of preferred shares or (2) subsequent ratification by holders of a majority of the outstanding preferred shares. In such special meetings, each preferred share will entitle the holder thereof to one vote.

Pursuant to the recent amendments to the Brazilian Corporate Law, shareholders that together hold preferred shares representing at least 10% of our total share capital are entitled to appoint a member of our board of directors. To date, none of our directors was appointed by our preferred shareholders.

7B. Related Party Transactions

We have engaged in a number of transactions with our subsidiaries, the Brazilian government and affiliates of Cia. Bozano, as described below. According to the shareholders' agreement, our controlling shareholders will not permit us to engage in transactions or arrangements with any of our affiliates on a basis or terms less favorable to us than would be obtainable at that time from an unaffiliated third party in an arm's-length transaction or other arrangement.

Brazilian Government

The Brazilian government, principally through the Brazilian Air Force, has participated in the development of Embraer since its inception. For the years ended December 31, 2000, 2001 and 2002, the Brazilian government accounted for approximately 2.6%, 1.5% and 1.6% of our net sales, respectively. We expect to continue to be the primary source of new aircraft and spare parts and services for the Brazilian government. For a description of our transactions with the Brazilian government, see Item 4B. Business Overview Defense Business.

The Brazilian government plays a key role as:

a source for research and development debt financing through technology development institutions such as FINEP and BNDES; and

an export support agency through BNDES.

See Item 4B. Business Overview Aircraft Financing Arrangements, Item 3D. Risk Factors Risks Related to Embraer Any decrease in Brazilian government-sponsored customer financing, or increase in government-sponsored financing that benefits our competitors, may decrease the cost-competitiveness of our aircraft and Item 3D. Risk Factors Risks Related to Embraer Brazilian government budgetary constraints could reduce amounts available to our customers under government-sponsored financing programs.

We maintain credit facilities with BNDES and FINEP, primarily to fund development costs of the ERJ 145 and AL-X, of which US\$47.9 million and US\$5.4 million was outstanding, respectively, at December 31, 2002. Amounts borrowed from BNDES are secured by first, second and third mortgages on Embraer's properties in Brazil. The interest rates under our FINEP credit facility range from TJLP plus 3.0% to TJLP plus 5.5% per annum. The interest rates under our BNDES credit facility are either fixed at 5.5% per annum or range from TJLP plus 3.3% to TJLP plus 4.4%, plus fees at the rate of 0.35% of the sales price of 420 ERJ 145s sold between January 1, 1997 and August 1, 2002.

The Brazilian government has been an important source of export financing for our customers through the BNDES-*exim* program, administered by BNDES. In addition, Banco do Brasil S.A., which is owned by the Brazilian government, administers the ProEx program, which enables some of our customers to receive the benefit of interest discounts.

In connection with a private offering of exchangeable notes by BNDES completed on June 19, 2001, we became party to a registration rights agreement pursuant to which we agreed, among other things, to register resales of the ADSs and underlying preferred shares relating to the exchangeable notes. We agreed to indemnify the initial purchasers of these notes and holders selling under our resale registration statement against certain liabilities under the Securities Act, or to contribute to payments that they may be required to make in respect of those liabilities.

In February and March of 1999, we sold a total of 83,330 debentures with a principal amount of R\$1,800 per debenture with a term of seven years, mostly to BNDESPAR, a wholly owned subsidiary of BNDES. We coupled each debenture with 100 detachable subscription warrants issued in five series. Each warrant entitled its holder to subscribe for ten preferred shares or, under some limited circumstances, ten common shares of Embraer. In February 2000, holders exercised 833,500 of these subscription warrants, resulting in our issuing 8,335,000 preferred shares at an issue price of R\$2.1998 per share. After that date, BNDESPAR became the only holder of subscription warrants. In July 2000, BNDESPAR exercised 105,700 of the subscription warrants, resulting in our issuing 1,057,000 preferred shares at an issue price of R\$2.4769 per share. On May 3, 2001, BNDESPAR exercised its remaining 7,393,800 warrants in exchange for 73,938,000 preferred shares at an issue price of R\$2.4769 per share.

We have entered into numerous financing transactions from time to time in the past with the Brazilian government-owned Banco do Brasil S.A. and its affiliates. At December 31, 2000, 2001 and 2002, we maintained cash investments of US\$46.9 million, US\$69.5 million and US\$74.1 million, respectively, with Banco do Brasil S.A. and several of its affiliates. We also had outstanding borrowings from Banco do Brasil S.A. and several of its affiliates, which at December 31, 2000, 2001 and 2002 equaled US\$331.0 million, US\$182.3 million and US\$213.1 million, respectively. In addition, BB Banco de Investimento, S.A., an affiliate of Banco do Brasil S.A., was an underwriter in a secondary offering in Brazil, completed on June 19, 2001, in which some of our shareholders sold an aggregate of 6,900,000 of our preferred shares.

European Aerospace and Defense Group

Thales, a member of the European Aerospace and Defense Group, is also a joint venture partner with the General Electric Company in a company called GE Capital Aviation Training Limited, or GECAT. We have entered into an agreement with GECAT whereby GECAT will provide training for the EMBRAER 170/190 jet family on a non-exclusive basis. We will pay GECAT for the training services to be provided by GECAT to our customers for the EMBRAER 170/190 jet family and for each component of the system to be supplied by GECAT to provide training for our customers for the EMBRAER 170/190 jet family, which system includes flight simulators, courseware, training media, computer-based training, and training courses.

In March 2002, we formed a consortium with Dassault, Thales and SNECMA to bid on the development and manufacture of up to 24 fighter jets for the Brazilian Air Force. The planned jet, the Mirage 2000 BR, is modeled on the Dassault Mirage 2000-5 supersonic jet. As leaders of the consortium, we would have coordination and management responsibilities in the program. As a result of this consortium and as part of our strategic alliance agreement, Dassault would transfer to us the technology for the Mirage, enabling us to have full control over the project technology as well. The selection of the winner of the bid has not yet been made.

Cia. Bozano

From time to time we hold temporary cash investments through Cia. Bozano. At December 31, 2002, we had US\$151,000 of such temporary investments.

See Note 33 to our consolidated financial statements for more information regarding related party transactions.

7C. Interests of Experts and Counsel

Not applicable.

ITEM 8. FINANCIAL INFORMATION

8A. Consolidated Statements and Other Financial Information

See Item 3A. Selected Financial Data and Item 18. Financial Statements.

Legal Proceedings

We have some individual labor lawsuits, and we have already settled several of them, but we are awaiting the decision of the Brazilian labor courts on others. We do not believe that any liabilities related to these individual lawsuits will have a material adverse effect on our financial condition or results of operations.

We have challenged the constitutionality of the nature of and modifications in rates and the increase in the calculation base of certain Brazilian taxes and social charges in order to obtain writs of mandamus or injunctions to avoid payments or recover past payments. Interest on the total amount of unpaid taxes and social charges accrues monthly based on the Selic rate, the key lending rate of the Central Bank, and we make an accrual as part of the interest income (expense) item of our statements of income. As of December 31, 2002, we had obtained preliminary injunctions for not paying or recovering past payments in the total amount, including interest, of US\$186.9 million, which is included as a liability on our balance sheet. See Item 3D. Risk Factors Risks Relating to Embraer We may have to make significant payments as a result of unfavorable outcomes of pending challenges to certain taxes and social charges and Note 18 to our consolidated financial statements for a further discussion of these challenges.

In addition, we are involved in other legal proceedings, including tax disputes, all of which are in the ordinary course of business. Our management believes that none of these other proceedings, if adversely determined, would materially or adversely affect our business, financial condition or results of operations. See Note 19 to our consolidated financial statements for a further discussion of the legal proceedings we face.

Dividends and Dividend Policy

Amounts Available for Distribution

At each annual shareholders meeting, the board of directors is required to recommend how net profits for the preceding fiscal year are to be allocated. For purposes of the Brazilian Corporate Law, net profits are defined as net income after income taxes and social contribution taxes for such fiscal year, net of any accumulated losses from prior fiscal years and any amounts allocated to employees and management's participation in our profits. In accordance with the Brazilian Corporate Law and our bylaws, the amounts available for dividend distribution are the amounts equal to our net profits less any amounts allocated from such net profits to:

the legal reserve;

a contingency reserve for anticipated losses; and

an unrealized revenue reserve.

We are required to maintain a legal reserve, to which we must allocate 5% of net profits for each fiscal year until the amount for such reserve equals 20% of our paid-in capital. However, we are not required to make any allocations to our legal reserve in respect of any fiscal year in which it, when added to our other established capital reserves, exceeds 30% of our capital. Net losses, if any, may be charged against the legal reserve. At December 31, 2002, the balance of our legal reserve was US\$76.2 million, which was equal to 8.5% of our paid-in capital at December 31, 2002.

The Brazilian Corporate Law also provides for two additional, discretionary allocations of net profits that are subject to approval by the shareholders at the annual meeting. First, a percentage of net profits may be allocated to a contingency reserve for anticipated losses that are deemed probable in future years. Any amount so allocated in a prior year must be either reversed in the fiscal year in which the loss was anticipated if such loss does not in fact

occur, or written off in the event that the anticipated loss occurs. Second, if the amount of unrealized revenue exceeds the sum of:

the legal reserve;

the investment and working capital reserve;

retained earnings; and

the contingency reserve for anticipated losses,

such excess may be allocated to an unrealized revenue reserve. Under the Brazilian Corporate Law, unrealized revenue is defined as the sum of:

price-level restatement of balance sheet accounts;

the share of equity earnings of affiliated companies; and

profits from installment sales to be received after the end of the next succeeding fiscal year.

According to our bylaws and subject to shareholders' approval, our board of directors may allocate at least 5% of our net income to an investment and working capital reserve. The purpose of the investment and working capital reserve is to make investments in fixed assets or increase our working capital. This reserve may also be used to amortize our debts. We may also grant a participation in our net income to our management and employees. However, the allocation to the investment and working capital reserve or the participation of our management and employees cannot reduce the mandatory distributable amount (discussed below). The balance of the investment and working capital reserve plus the balance of other profit reserves (except the contingency reserve for anticipated losses and the unrealized revenue reserve) may not be higher than our capital. Otherwise, the amount in excess of our capital must be used to increase our capital or be distributed as a cash dividend. The balance of the investment and working capital reserve may be used:

in the deduction of accumulated losses, whenever necessary;

in the distribution of dividends, at any time;

in the redemption, withdrawal, purchase or open market repurchase of shares, as authorized by law; and

to increase our capital, including by means of an issuance of new shares.

The amounts available for distribution may be further increased by a reversion of the contingency reserve for anticipated losses constituted in prior years but not realized, or further increased or reduced as a result of the allocations of revenues to or from the unrealized revenue reserve. The amounts available for distribution are determined on the basis of financial statements prepared in accordance with the Brazilian Corporate Law method.

Mandatory Distribution

The Brazilian Corporate Law generally requires that the bylaws of each Brazilian corporation specify a minimum percentage of the amounts available for distribution by such corporation for each fiscal year that must be distributed to shareholders as dividends, also known as the mandatory distributable amount. Under our bylaws, the mandatory distributable amount has been fixed at an amount equal to not less than 25% of the amounts available for distribution, to the extent amounts are available for distribution. On May 5, 1997, Law No. 9,457 became effective, granting holders of preferred stock not carrying a right to fixed or minimum dividends, such as our preferred shares, a statutory right to receive dividends in an amount per share of at least 10% more than the amount per share paid to holders of common stock.

The mandatory distribution is based on a percentage of adjusted net income, not lower than 25%, rather than a fixed monetary amount per share. The Brazilian Corporate Law, however, permits a publicly held company, such as Embraer, to suspend the mandatory distribution of dividends if the board of directors and the audit committee report to the shareholders' meeting that the distribution would be inadvisable in view of the company's financial condition. This suspension is subject to approval of holders of common shares. In this case, the board of directors shall file a justification for such suspension with the CVM. Profits not distributed by virtue of the suspension mentioned above shall be attributed to a special reserve and, if not absorbed by subsequent losses, shall be paid as dividends as soon as the financial condition of such company permits such payments. As our preferred shares are not entitled to a fixed or minimum dividend, our ability to suspend the mandatory distribution of dividends applies to the holders of preferred shares and, consequently, to the holders of ADSs.

Payment of Dividends

We are required by the Brazilian Corporate Law and by our bylaws to hold an annual shareholders' meeting by the fourth month after the end of each fiscal year at which, among other things, the shareholders have to decide on the payment of an annual dividend. The payment of annual dividends is based on the financial statements prepared for the relevant fiscal year. Under the Brazilian Corporate Law, dividends generally are required to be paid within 60 days following the date the dividend was declared, unless a shareholders' resolution sets forth another date of payment, which, in either case, must occur prior to the end of the fiscal year in which the dividend was declared. A shareholder has a three-year period from the dividend payment date to claim dividends (or interest payments) in respect of its shares, after which the amount of the unclaimed dividends reverts to us.

The Brazilian Corporate Law permits a company to pay interim dividends out of preexisting and accumulated profits for the preceding fiscal year or semester, based on financial statements approved by its shareholders. According to our bylaws, the shareholders may declare, at any time, interim dividends based on the preexisting and accumulated profits, provided the mandatory dividend has already been distributed to the shareholders. Our bylaws also permit us to prepare financial statements semiannually and for shorter periods. Our board of directors may approve the distribution of dividends calculated with reference to those financial statements, even before they have been approved by the shareholders. However, such dividends cannot exceed the amount of capital reserves.

In general, shareholders who are not residents of Brazil must register with the Central Bank to have dividends, sales proceeds or other amounts with respect to their shares eligible to be remitted outside of Brazil. The preferred shares underlying our ADSs will be held in Brazil by Banco Itaú S.A., also known as the custodian, as agent for the depositary, which will be the registered owner on the records of the registrar for our shares. Our current registrar is Banco Itaú. The depositary electronically registered the preferred shares underlying our ADSs with the Central Bank and, therefore, is able to have dividends, sales proceeds or other amounts with respect to these shares eligible to be remitted outside Brazil.

Payments of cash dividends and distributions, if any, will be made in Brazilian currency to the custodian on behalf of the depositary, which will then convert such proceeds into U.S. dollars and will cause such U.S. dollars to be delivered to the depositary for distribution to holders of ADSs. Under current Brazilian law, dividends paid to shareholders who are not Brazilian residents, including holders of ADSs, will not be subject to Brazilian withholding income tax, except for dividends declared based on profits generated prior to December 31, 1995. See Item 10E. Taxation - Brazilian Tax Consequences.

History of Dividend Payments and Dividend Policy and Additional Payments on Shareholders' Equity

We did not pay dividends from 1988 through 1997 because we did not have net profits for any year during that period. On January 16, 1998, we reduced our capital in order to offset our accumulated deficit. As a result, we were then able to distribute profits achieved in 1998.

Law No. 9,249, dated December 26, 1995, as amended, provides for distribution of interest on net worth to shareholders as an alternative form of payment to shareholders. Such interest is limited to the daily *pro rata* variation of the TJLP and cannot exceed the greater of:

50% of net income (after taking into account the provisions for the *Contribuição Social sobre o Lucro Líquido*, or Social Contribution on Net Profits, or CSLL, but before taking into account such distribution and any deductions for income taxes) for the period in respect of which the payment is made; or

50% of the sum of retained earnings and profit reserves as of the beginning of the year in respect of which the payment is made.

Distribution of interest on net worth may also be accounted for as a tax deductible expense. Any payment of interest on shareholders' equity to holders of ADSs or preferred shares, whether or not they are Brazilian residents, is subject to Brazilian withholding income tax at the rate of 15% or 25% if the beneficiary is resident in a tax haven. See Item 10E. Taxation Brazilian Tax Consequences. The amount paid to shareholders as interest on net worth, net of any withholding tax, may be included as part of any mandatory distributable amount. Under Brazilian law, we are obligated to distribute to shareholders an amount sufficient to ensure that the net amount received by them, after payment by us of applicable Brazilian withholding taxes in respect of the distribution of interest on net worth, is at least equal to the mandatory distributable amount. When we distribute interest on net worth, and that distribution is not accounted for as part of the mandatory distribution, Brazilian withholding tax will apply. All payments to date were accounted for as part of the mandatory distribution.

The following table sets forth the historical payments of dividends and historical payments of interest on shareholders' equity we made to our shareholders.

Date of approval	Period in which profits were generated	Total amount of distribution (US\$ in millions)
September 18, 1998(1)	First two quarters of 1998	18.0
March 30, 1999(1)	Remaining two quarters of 1998	27.7
September 28, 1999(1)	First two quarters of 1999	20.8
January 31, 2000(1)	Remaining two quarters of 1999	48.3
March 24, 2000(2)	First quarter of 2000	11.2
June 16, 2000(2)	Second quarter of 2000	11.0
July 6, 2000(1)	First two quarters of 2000	44.2
September 22, 2000(2)	Third quarter of 2000	15.0
December 15, 2000(2)	Fourth quarter of 2000	17.1
March 16, 2001(1)	Remaining two quarters of 2000	51.4
March 16, 2001(2)	First quarter of 2001	15.7
June 13, 2001(2)	Second quarter of 2001	18.0
September 14, 2001(1)	First two quarters of 2001	53.4
September 14, 2001(2)	Third quarter of 2001	18.1
December 15, 2001(2)	Fourth quarter of 2001	24.6
March 19, 2002(1)	Remaining two quarters of 2001	43.1
March 19, 2002(2)	First quarter of 2002	25.4
June 14, 2002(2)	Second quarter of 2002	20.9
September 13, 2002(2)	Third quarter of 2002	17.0
December 13, 2002(2)	Fourth quarter of 2002	19.8
December 13, 2002(2)	1998 and 1999	20.5

(1) Represents dividend payments.

(2) Represents interest on shareholders' equity.

Further, on June 16, 2003, our Board of Directors approved the payment of interest on shareholders' equity for the first two quarters of 2003 in the total amount of R\$76.7 million to be paid on August 15, 2003, which, translated using the exchange rate on June 16, 2003, would be equivalent to US\$26.8 million.

On March 1, 2002, we issued 88,430,168 preferred shares in the form of a stock dividend to each holder of common and preferred shares at that date, at the rate of 0.142106 new preferred shares for each existing share.

We intend to declare and pay dividends and/or interest on shareholders' equity, as required by the Brazilian Corporate Law and our bylaws. Our Board of Directors may approve the distribution of dividends and/or interest on shareholders' equity, calculated based on our semiannual or quarterly financial statements. The declaration of annual dividends, including dividends in excess of the mandatory distribution, requires approval by the vote of the majority of the holders of our common stock. The amount of any distributions will depend on many factors, such as our results of operations, financial condition, cash requirements, prospects and other factors deemed relevant by our board of directors and shareholders. Within the context of our tax planning, we may in the future continue determining that it is to our benefit to distribute interest on shareholders' equity.

8B. Significant Changes

No significant changes or events have occurred after the close of the balance sheet date at December 31, 2002, other than the events already described in this annual report.

ITEM 9. THE OFFER AND LISTING

9A. Offer and Listing Details

Our ADSs are listed on the New York Stock Exchange under the symbol ERJ. In addition, our preferred shares are traded on the São Paulo Stock Exchange under the symbol EMBR4. Each ADS represents four preferred shares.

The reported high and low closing sale prices in U.S. dollars for the ADSs on the New York Stock Exchange for the periods indicated are set forth in the following table:

	Price in U.S. dollars per ADS	
	High	Low
2000:		
Year end (from July 20)	39.75	18.50
2001:		
First quarter	41.75	34.50
Second quarter	45.50	36.00
Third quarter	39.45	11.95
Fourth quarter	22.20	11.45
Year end	45.50	11.45
2002:		
First quarter	25.01	19.85
Second quarter	23.77	19.09
Third quarter	21.20	13.30
Fourth quarter	16.47	12.85
Year end	25.01	12.85
2003:		
First quarter	16.27	9.15
Second quarter (through June 16)	20.26	9.48
Month ended:		
December 31, 2002	16.05	14.43
January 31, 2003	16.27	13.40
February 28, 2003	13.92	9.15
March 31, 2003	11.97	9.48
April 30, 2003	14.59	12.38
May 31, 2003	15.37	14.00
June 30, 2003 (through June 16)	20.26	14.92

The table below sets forth, for the periods indicated, the reported high and low closing sale prices in nominal *reais* for preferred shares on the São Paulo Stock Exchange. The preferred shares have not traded every day on which the São Paulo Stock Exchange was open. The common shares are also listed and traded on the São Paulo Stock Exchange.

	Nominal <i>reais</i> per preferred share	
	High	Low
1998:		
Year end	2.23	1.15
1999:		
Year end	8.15	1.15
2000:		
Year end	18.30	7.20
2001:		
First quarter	21.50	17.82
Second quarter	25.45	19.40
Third quarter	23.30	8.30
Fourth quarter	13.20	7.65
Year end	25.45	7.65
2002:		
First quarter	15.20	11.66
Second quarter	15.30	11.20
Third quarter	15.19	12.30
Fourth quarter	15.00	12.40
Year end	15.30	11.20
2003:		
First quarter	14.05	8.10
Second quarter (through June 16)	14.31	9.84
Month ended:		
December 31, 2002	14.00	13.46
January 31, 2003	14.05	12.21
February 28, 2003	12.29	8.10
March 31, 2003	10.14	8.13
April 30, 2003	10.96	9.84
May 31, 2003	11.15	10.25
June 30, 2003 (through June 16)	14.31	11.01

On June 16, 2003, we had 25,219 holders, either directly or through ADSs, of preferred shares, and 4,167 holders of record of common shares. On June 16, 2003, an aggregate of 209,410,561 preferred shares were held, either directly or through ADSs, by 188 record holders, including DTC, in the United States.

On June 16, 2003, the closing sale price for our preferred shares on the São Paulo Stock Exchange was R\$14.12, which is equivalent to US\$19.77 per ADS. On the same date, the closing sale price for our ADSs on the New York Stock Exchange was US\$19.63. The ADSs are issued under a deposit agreement and JPMorgan Chase Bank serves as depositary under that agreement.

9B. Plan of Distribution

Not applicable.

9C. Markets

Trading on the São Paulo Stock Exchange

On January 27, 2000, protocols were signed in order to merge the nine Brazilian stock exchanges. Pursuant to the protocols, publicly traded Brazilian companies' securities are traded on the São Paulo Stock Exchange, and Brazilian government debt securities are traded on, and privatization auctions are carried out at, the Rio de Janeiro Stock Exchange. Trading on each exchange is limited to member brokerage firms and a limited number of authorized non-members. The CVM and the São Paulo Stock Exchange have discretionary authority to suspend trading in shares of a particular issuer. Trading in securities listed on the São Paulo Stock Exchange may be effected off the exchange, although such trading is limited.

The preferred shares are listed and traded on the São Paulo Stock Exchange. Trades in our preferred shares on the São Paulo Stock Exchange settle in three business days after the trade date. Delivery of and payment for shares is made through the facilities of the *CBLC Companhia Brasileira de Liquidação e Custódia*, the clearinghouse for the São Paulo Stock Exchange, which maintains accounts for member brokerage firms. The seller is ordinarily required to deliver the shares to the exchange on the second business day following the trade date.

In order to better control volatility, the São Paulo Stock Exchange adopted a circuit breaker system pursuant to which trading sessions may be suspended for a period of 30 minutes or one hour whenever the indices of this stock exchange fall below the limit of 10% and 15%, respectively, in relation to the index registered in the previous trading session.

The São Paulo Stock Exchange is less liquid than the New York Stock Exchange and other major exchanges in the world. The São Paulo Stock Exchange had an aggregate market capitalization of approximately US\$156.9 billion at May 31, 2003. In comparison, the New York Stock Exchange had a market capitalization of approximately US\$13.9 trillion at the same date. Although any of the outstanding shares of a listed company may trade on the São Paulo Stock Exchange, in most cases fewer than one-half of the listed shares are actually available for trading by the public, the remainder being held by small groups of controlling persons, by governmental entities or by one principal shareholder. At May 31, 2003, we accounted for approximately 1.6% of the market capitalization of all listed companies on the São Paulo Stock Exchange.

There is also significantly greater concentration in the Brazilian securities markets than in the New York Stock Exchange or other major exchanges. During the one year period ended May 31, 2003, the five most actively traded shares represented approximately 41.6% of the total volume of shares traded on the São Paulo Stock Exchange.

Trading on the São Paulo Stock Exchange by non-residents of Brazil is subject to limitations under Brazilian foreign investment legislation.

Regulation of Brazilian Securities Markets

The Brazilian securities markets are regulated by the CVM, which has regulatory authority over stock exchanges and the securities markets generally, and by the Central Bank, which has, among other powers, licensing authority over brokerage firms and regulates foreign investment and foreign exchange transactions.

Under the Brazilian Corporate Law, a corporation is either public (*companhia aberta*), like us, or closely held (*companhia fechada*). All public companies, including us, are registered with the CVM and are subject to reporting requirements. Our shares are listed and traded on the São Paulo Stock Exchange and may be traded privately subject to limitations.

We have the option to ask that trading in our securities on the São Paulo Stock Exchange be suspended in anticipation of a material announcement. Trading may also be suspended on the initiative of the São Paulo Stock Exchange or the CVM, among other reasons, based on or due to a belief that a company has provided inadequate

information regarding a material event or has provided inadequate responses to the inquiries by the CVM or the São Paulo Stock Exchange.

The Brazilian securities law, the Brazilian Corporate Law and the regulations issued by the CVM, the National Monetary Council and the Central Bank provide for, among other things, disclosure requirements, restrictions on insider trading and price manipulation, and protection of minority shareholders. However, the Brazilian securities markets are not as highly regulated and supervised as the U.S. securities markets or markets in other jurisdictions.

Trading on the São Paulo Stock Exchange by non-residents of Brazil is subject to limitations under Brazilian foreign investment and tax legislation. The Brazilian custodian for our preferred shares and the depository for our ADSs have obtained an electronic certificate of registration from the Central Bank to remit U.S. dollars abroad for payments of dividends, any other cash distributions, or upon the disposition of the shares and sales proceeds thereto. In the event that a holder of ADSs exchanges ADSs for preferred shares, the holder will be entitled to continue to rely on the depository's electronic certificate of registration for five business days after the exchange. Thereafter, the holder may not be able to obtain and remit U.S. dollars abroad upon the disposition of the preferred shares, or distributions relating to the preferred shares, unless the holder obtains a new electronic certificate of registration or registers its investment in the preferred shares under Resolution No. 2,689.

9D. Selling Shareholders

Not applicable.

9E. Dilution

Not applicable.

9F. Expenses of the Issue

Not applicable.

ITEM 10. ADDITIONAL INFORMATION

10A. Share Capital

Not applicable.

10B. Memorandum and Articles of Association

Set forth below is material information concerning our capital stock, and a brief summary of certain significant provisions of our bylaws and the Brazilian Corporate Law. This description does not purport to be complete and is qualified by reference to our bylaws and to Brazilian law.

Corporate Purposes

We are a joint stock company with a principal place of business and jurisdiction in the city of São José dos Campos, São Paulo, Brazil, governed mainly by our bylaws and the Brazilian Corporate Law. Our corporate purpose, as stated in our bylaws, is to (1) design, manufacture and market aircraft and aerospace materials and their respective accessories, components and equipment in accordance with the highest technology and quality standards, (2) promote and carry out technical activities related to the production and maintenance of aerospace materials, (3) contribute towards the education of technical personnel required for the aerospace industry and (4) conduct technological, industrial and commercial activities and services related to the aerospace industry.

Description of Capital Stock

General

At December 31, 2002, our capital stock consisted of a total of 712,974,356 outstanding shares, without par value, of which 242,544,448 were common shares, including one special class of common share known as the golden share, held by the Brazilian government, and 470,429,907 were preferred shares. Our bylaws authorize the board of directors to increase the capital stock up to 500,000,000 common shares and up to 1,000,000,000 preferred shares, without seeking specific shareholder approval. All our outstanding shares are fully paid. Our shareholders must approve at a shareholders meeting any capital increase that exceeds the above-referenced authorized amounts. Under the Brazilian Corporate Law, however, the number of non-voting preferred shares may not exceed two-thirds of the total number of shares. According to the edital (invitation to bid) issued by the Brazilian government in connection with our privatization in 1994, non-Brazilians may not hold in excess of 40% of our common shares. There is no similar restriction on ownership of our preferred shares.

Common Shares

Each common share entitles the holder thereof to one vote at our annual and special shareholders meetings. The Brazilian Corporate Law and our bylaws require that all our shareholders meetings be called by publication of a notice in the Diário Oficial do Estado de São Paulo, the official government publication of the State of São Paulo, and in a newspaper of general circulation in our principal place of business, currently São José dos Campos, at least fifteen days prior to the meeting. The quorum to hold shareholders meetings on first call is generally 25% of the shares entitled to vote, and on second call the meetings can be held with the presence of any number of the shares entitled to vote.

According to the Brazilian Corporate Law, the common shares are entitled to dividends in proportion to their share of the amount available for distribution, subject to any preference of the preferred shares. See Item 8A. Consolidated Statements and Other Financial Information Dividends and Dividend Policy for a more complete description of payment of dividends on our shares. In addition, upon any liquidation of the company, the common shares are entitled to return of capital in proportion to their share of our net worth, also subject to the preference of the preferred shares.

Preferences of Preferred Shares

According to our bylaws, the preferred shares are non-voting except under limited circumstances and, upon any liquidation of the Company, are entitled to priority over the common shares in the return of capital in proportion to their share of our net worth. In addition, according to our bylaws, the preferred shares are not entitled to fixed or minimum dividend payments. However, under the Brazilian Corporate Law, preferred shares, not entitled to fixed or minimum dividend payments, are entitled to receive dividends in an amount per share that is 10% greater than the dividends payable on our common shares. See Item 8A. Consolidated Statements and Other Financial Information Dividends and Dividend Policy for a more complete description of mandatory annual distributions on our preferred stock.

Golden Share

The golden share is held by the Federative Republic of Brazil. The golden share is entitled to the same voting rights as the holders of common shares. In addition, the golden share entitles the holder thereof to veto rights over the following corporate actions:

change of our name and corporate purpose;

amendment to and/or extension of our logo;

creation and/or alteration of military programs (whether or not involving Brazil);

third party training in technology for military programs;

discontinuance of the supply of military airplane maintenance and replacement parts;

transfer of share control; and

any change to the list of corporate actions over which the golden share carries veto power, to the structure and composition of the board of directors, and to the rights conferred to the golden share.

Voting Rights of the Preferred Shares

Preferred shares do not entitle the holder to vote except as set forth below. However, holders of preferred shares are entitled to attend meetings of shareholders and to participate in the discussion of matters submitted for consideration.

The Brazilian Corporate Law requires that non-voting preferred shares which are entitled to receive fixed or minimum dividends shall acquire voting rights in the event a company fails to pay, from one to three consecutive fiscal years as established in the bylaws, the fixed or minimum dividend to which such shares are entitled. Because our preferred shares are not entitled to fixed or minimum dividends, they cannot acquire voting rights under this rule. However, our preferred shares are entitled to their share of any mandatory dividends distributions that we make. See Item 8A. Consolidated Statements and Other Financial Information Dividends and Dividend Policy Amounts Available for Distribution.

Any change in the preference or rights of preferred shares, or the creation of a class of shares having priority or preference over preferred shares, requires approval by at least half of all outstanding voting shares and either (1) prior approval of holders of a majority of the outstanding preferred shares at a special meeting of holders of preferred shares or (2) subsequent ratification by holders of a majority of the outstanding preferred shares. The meeting may be called by publication of a notice in the *Diário Oficial do Estado de São Paulo* and in a newspaper of general circulation in our principal place of business, currently São José dos Campos, at least fifteen days prior to the meeting. In such special meetings, each preferred share will entitle the holder thereof to one vote.

Conversion Rights

The shareholders may authorize the conversion of the common shares into preferred shares on a voluntary basis and in the proportion of the requests received, in case the requests are higher than the authorized amount of the conversion; provided that, as a result of such conversion, the number of non-voting shares, such as our preferred shares, remains below the limit of two-thirds of our capital stock.

Form and Transfer

As our shares are in registered book-entry form, the transfer of shares is governed by the rules of Article 35 of the Brazilian Corporate Law. This Article provides that a transfer of shares is effected by an entry made by Banco Itaú S.A., also known as the registrar, in its books, by debiting the share account of the transferor and crediting the share account of the transferee. Banco Itaú also performs all the services of safe-keeping and transfer of shares and related services for us.

Transfers of shares by a foreign investor are made in the same way and executed by that investor's local agent on the investor's behalf except that, if the original investment was registered with the Central Bank pursuant to Resolution No. 2,689, the foreign investor must also seek amendment, if necessary, through its local agent, of the electronic registration to reflect the new ownership.

The São Paulo Stock Exchange operates as a central clearing system. A holder of our shares may choose, in its discretion, to participate in this system and all shares elected to be put into this system will be deposited in custody with the São Paulo Stock Exchange (through a Brazilian institution duly authorized to operate by the Central Bank and having a clearing account with the São Paulo Stock Exchange). The fact that those shares are held

in custody with the São Paulo Stock Exchange will be reflected in our register of shareholders. Each participating shareholder will, in turn, be registered in our register of beneficial shareholders maintained by the São Paulo Stock Exchange and will be treated in the same way as registered shareholders.

Board of Directors

Under Brazilian Corporate Law, the members of a company's Board of Directors must be shareholders of the company. There is no requirement as to the number of shares an individual must own in order to act as a member of the board of directors.

According to Brazilian Corporate Law, our officers and directors are prohibited from voting on, or acting in, matters in which their interests conflict with ours.

Our by-laws provide that the shareholders are responsible for determining the global remuneration of the members of our management bodies. Our Board of Directors is responsible for dividing such remuneration among the members of management. There are no specific provisions regarding the directors' power to vote on their compensation in the absence of an independent quorum.

With respect to the borrowing powers of the Board of Directors, the Board of Directors have the power to authorize borrowing of funds, either in the form of bonds, notes, commercial papers or other instruments of regular use in the market. Other financing arrangements, including bank loans, may be entered into by us upon the joint signatures of (i) two executive officers; (ii) one officer and one attorney-in-fact; or (iii) two attorneys-in-fact.

There is no requirement under Brazilian Corporate Law or our bylaws that directors retire upon reaching a certain age. In addition, our bylaws do not provide for the reelection of directors at staggered intervals.

For a discussion of our Board of Directors, see Item 6A. Directors and Senior Management Board of Directors and Item 6C. Board Practices.

Limitations on Share Ownership

According to the *edital* (invitation to bid) issued by the Brazilian government in connection with our privatization in 1994, non-Brazilians may not hold in excess of 40% of our common shares. There is no similar restriction on ownership of our preferred shares. However, foreign investments must be registered with the Central Bank and/or CVM, as the case may be. See Item 10D. Exchange Controls. In addition, there are no legal limitations on the rights of non-resident or foreign shareholders to exercise their voting rights as shareholders.

There are no provisions in our bylaws with respect to the disclosure of share ownership. Notwithstanding, Brazilian Corporate Law states that a corporation shall provide information regarding their share registry book to any person, provided that such information is necessary to protect any rights or clarify situations involving interests of (i) the requesting person, (ii) a shareholder or (iii) the securities market.

Changes to the Brazilian Corporate Law

The Brazilian Congress enacted Law No. 10,303 on October 31, 2001, which modified several provisions of the Brazilian Corporate Law and became effective with respect to us in March 2002. According to this new law, preferred shareholders who own at least 10% of the total share capital of a company and common shareholders who own at least 15% of the total common shares of a company are each entitled to elect, in a separate election, a representative to the board of directors. If preferred shareholders and common shareholders cannot separately achieve the 10% and 15% levels, respectively, preferred shareholders and common shareholders who together own at least 10% of the total share capital of a company will be entitled to elect, in a separate election, a representative to the board of directors. Law 10,303 also modified the minimum rights attributed to preferred shares, appraisal rights, share redemption procedures and requirements for the disclosure of trades by insiders.

10C. Material Contracts

Joint Venture with Liebherr International AG

We entered into a joint venture with Liebherr International AG to develop and manufacture landing gear and high precision hydraulic equipment and provide related services for Embraer and other clients around the world. In connection with this joint venture, we formed a new subsidiary, ELEB, to which we transferred all of our landing gear manufacturing activities, the employees and some liabilities related to those activities on December 1, 1999. On May 22, 2000, Liebherr International AG, acting in coordination with its subsidiary, Liebherr Aerospace Lindenberg GmbH, and through its Brazilian affiliate, purchased 40% of the capital stock of ELEB. Liebherr-Aerospace SAS is our risk-sharing partner responsible for designing, developing and manufacturing the landing gear assemblies for the new EMBRAER 170/190 jet family.

10D. Exchange Controls

There are no restrictions on ownership of our preferred shares by individuals or legal entities domiciled outside Brazil. However, the right to convert dividend payments and proceeds from the sale of preferred shares into foreign currency and to remit such amounts outside Brazil is subject to restrictions under foreign investment legislation which generally requires, among other things, the registration of the relevant investment with the Central Bank.

Under Resolution No. 2,689, foreign investors registered with the CVM may buy and sell shares on the São Paulo Stock Exchange without obtaining a separate certificate of registration for each transaction. Investors under these regulations are also generally entitled to favorable tax treatment.

Annex V to Resolution No. 1,289, as amended, of the National Monetary Council, also known as the Annex V Regulations, provides for the issuance of depositary receipts in foreign markets in respect of shares of Brazilian issuers.

In connection with both equity offerings of our preferred shares, an electronic registration was issued in the name of the depositary with respect to the ADSs and is maintained by the custodian on behalf of the depositary. This electronic registration was carried on through the Central Bank Information System-SISBACEN. Pursuant to the registration, the custodian and the depositary are able to convert dividends and other distributions with respect to the preferred shares represented by ADSs into foreign currency and remit the proceeds outside Brazil. In the event that a holder of ADSs exchanges such ADSs for preferred shares, the holder will be entitled to continue to rely on the depositary's registration for five business days after the exchange. Thereafter, a holder must seek to obtain its own electronic registration. Unless the preferred shares are held pursuant to Resolution No. 2,689 by a duly registered investor or a holder of preferred shares who applies for and obtains a new certificate of registration, that holder may not be able to convert into foreign currency and remit outside Brazil the proceeds from the disposition of, or distributions with respect to, the preferred shares. In addition, if the foreign investor resides in a tax haven jurisdiction or is not an investor registered under Resolution No. 2,689, the investor will be subject to less favorable Brazilian tax treatment than a holder of ADSs.

See Item 3D. Risk Factors Risks Relating to the Preferred Shares and the ADSs If holders of ADSs exchange the ADSs for preferred shares, they risk losing the ability to remit foreign currency abroad and Brazilian tax advantages and Item 10E. Taxation Brazilian Tax Consequences.

Preemptive Rights

Each of our shareholders has a general preemptive right to subscribe for shares or securities convertible into shares in any capital increase, in proportion to its shareholding, except in the event of the grant and exercise of any option to acquire shares of our capital stock. A period of at least 30 days following the publication of notice of the issuance of shares or securities convertible into shares is allowed for exercise of the right, and the right is negotiable. According to the Brazilian Corporate Law and our bylaws, the board of directors may, in its discretion, eliminate the preemptive rights of the shareholders in the event that we issue shares, debentures convertible into

shares, or subscription warrants that will be offered either through a stock exchange or in a public offering, or through an exchange of shares in a public offering, the purpose of which is to acquire control of another company, as established by law.

In the event of a capital increase by means of the issuance of new shares, holders of ADSs, or of preferred shares, would, except under circumstances described above, have preemptive rights to subscribe to any class of our newly issued shares. However, a holder may not be able to exercise the preemptive rights relating to the preferred shares underlying the ADSs unless a registration statement under the Securities Act is effective with respect to those shares to which the rights relate or an exemption from the registration requirements of the Securities Act is available. See Item 3D. Risk Factors Risks Relating to the Preferred Shares and the ADSs Holders of our ADSs might be unable to exercise preemptive rights with respect to the preferred shares.

Redemption and Right of Withdrawal

According to our bylaws, our common shares and preferred shares are not redeemable.

The Brazilian Corporate Law provides that, under limited circumstances, a shareholder has the right to withdraw his equity interest from the company and to receive payment for the portion of shareholder's equity attributable to his equity interest. This right of withdrawal may be exercised by dissenting shareholders of Embraer (including any holder of preferred shares) in the event that at least half of all voting shares outstanding authorize us:

to create preferred shares or to increase disproportionately an existing class of preferred shares relative to the other class of shares, unless such action is provided for or authorized by the bylaws;

to modify a preference, privilege or condition of redemption or amortization conferred on one or more classes of preferred shares, or to create a new class with greater privileges than the existing classes of preferred shares;

to reduce the mandatory distribution of dividends;

to change our corporate purpose;

to merge us into another company or to consolidate us with another company, subject to the conditions set forth in the Brazilian Corporate Law;

to transfer all of our shares to another company in order to make us a wholly owned subsidiary of such company, known as *incorporação de ações*;

to acquire control of another company at a price which exceeds the limits set forth in the Brazilian Corporate Law;

to participate in a centralized group of companies as defined under the Brazilian Corporate Law and subject to the conditions set forth therein; or

to conduct a spin-off that results in (a) a change of our corporate purposes, except if the assets and liabilities of the spun-off company are contributed to a company that is engaged in substantially the same activities, (b) a reduction in the mandatory dividend or (c) any participation in a centralized group of companies, as defined under Brazilian Corporate Law.

In addition, in the event that the entity resulting from a merger, or *incorporação de ações*, as described above, a consolidation or a spin-off of a listed company fails to become a listed company within 120 days of the shareholders' meeting at which such decision was taken, the dissenting or non-voting shareholders may also exercise their right of withdrawal.

Only holders of shares adversely affected by the changes mentioned in the first and second items above may withdraw their shares. The right of withdrawal lapses 30 days after publication of the minutes of the relevant shareholders' meeting. In the first two cases mentioned above, however, the resolution is subject to the prior approval or subsequent ratification by holders of a majority of the outstanding preferred shares, which must be obtained at a special meeting held within one year. In such cases, the 30-day term is counted from the date the minutes of the special meeting are published. We would be entitled to reconsider any action giving rise to withdrawal rights within ten days following the expiration of such rights if the withdrawal of shares of dissenting shareholders would jeopardize our financial stability. In addition, the rights of withdrawal in the fifth and eighth bullet points above may be exercised by holders of shares under other limited circumstances.

The Brazilian Corporate Law contains provisions that restrict withdrawal rights and allow companies to redeem their shares at their economic value, subject to certain requirements. As our bylaws currently do not provide that our shares would be redeemable at their economic value, our shares would be redeemable at their book value, determined on the basis of the last balance sheet approved by the shareholders. If the shareholders' meeting giving rise to withdrawal rights occurs more than 60 days after the date of the last approved balance sheet, a shareholder may demand that its shares be valued on the basis of a new balance sheet that is of a date within 60 days of such shareholders' meeting.

According to the Brazilian Corporate Law, in events of consolidation, merger, *incorporação de ações*, participation in a group of companies, and acquisition of control of another company, the right to withdraw does not apply if the shares in question meet certain tests relating to market liquidity and float. Shareholders would not be entitled to withdraw their shares if the shares are a component of a general stock index in Brazil or abroad and shares held by persons unaffiliated with the controlling shareholder represent more than half of the outstanding shares of the relevant type or class.

10E. Taxation

This summary contains a description of certain Brazilian and U.S. federal income tax consequences of the purchase, ownership and disposition of preferred shares or ADSs by a holder, also called a U.S. holder, that is the beneficial owner of preferred shares or ADSs and that is a citizen or resident alien of the United States or a U.S. domestic corporation or that otherwise will be subject to U.S. federal income tax on a net income basis in respect of preferred shares or ADSs, but it does not purport to be a comprehensive description of all of the tax considerations that may be relevant to a decision to purchase preferred shares or ADSs. In particular, this summary deals only with U.S. holders that will hold preferred shares or ADSs as capital assets and does not address the tax treatment of U.S. holders that own or are treated as owning 10% or more of our voting shares or that may be subject to special tax rules, such as banks, insurance companies, dealers in securities or currencies, individual retirement and other tax deferred accounts, tax-exempt organizations, persons that will hold preferred shares or ADSs as a position in a straddle, a hedging transaction or a conversion transaction for tax purposes, and persons that have a functional currency other than the U.S. dollar. Further, if a partnership (including for this purpose any entity treated as a partnership for U.S. federal income tax purposes) is a beneficial owner of preferred shares or ADSs, the treatment of a partner in a partnership will generally depend upon the status of a partner and upon the activities of the partnership. A holder of preferred shares or ADSs that is a partnership and partners in such partnership should consult their tax advisors. The summary is based upon the tax laws of Brazil and the United States as in effect on the date of this annual report, which are subject to change, possibly with retroactive effect, and to differing interpretations.

Although there presently is no income tax treaty between Brazil and the United States, the tax authorities of the two countries have had discussions that may culminate in such a treaty. No assurance can be given, however, as to if or when a treaty will enter into force or how it will affect the U.S. holders of preferred shares or ADSs.

Brazilian Tax Consequences

General. The following discussion summarizes the material Brazilian tax consequences of the acquisition, ownership and disposition of preferred shares or ADSs, as the case may be, by a holder that is not domiciled in Brazil, also called a non-Brazilian holder, for purposes of Brazilian taxation and, in the case of a holder of preferred shares, which has registered its investment in preferred shares at the Central Bank as a U.S. dollar investment.

Pursuant to Brazilian law, investors may invest in the preferred shares under Resolution No. 2,689, of January 26, 2000, of the National Monetary Council. The rules of Resolution No. 2,689 allow foreign investors to invest in almost all financial assets and to engage in almost all transactions available in the Brazilian financial and capital markets, provided that some requirements are fulfilled. In accordance with Resolution No. 2,689, the definition of foreign investor includes individuals, legal entities, mutual funds and other collective investment entities, domiciled or headquartered abroad.

Pursuant to the rules, foreign investors must: (1) appoint at least one representative in Brazil with powers to perform actions relating to the foreign investment; (2) complete the appropriate foreign investor registration form; (3) register as a foreign investor with the CVM; and (4) register the foreign investment with the Central Bank.

Securities and other financial assets held by foreign investors pursuant to Resolution No. 2,689 must be registered or maintained in deposit accounts or under the custody of an entity duly licensed by the Central Bank or the CVM. In addition, securities trading is restricted to transactions carried out in the stock exchanges or organized over-the-counter markets licensed by the CVM.

Taxation of Dividends. Dividends, including stock dividends and other dividends paid in property, paid by us to the depositary in respect of the ADSs, or to a non-Brazilian holder in respect of the preferred shares, are currently not subject to income withholding tax, provided that they are paid out of profits generated as of January 1, 1996 (or out of reserves derived therefrom). We do not have