PROSPECTUS

14,837,376 AMERICAN DEPOSITARY SHARES
REPRESENTING 59,349,504 PREFERRED SHARES

Some of our principal shareholders are offering 14,837,376 ADSs representing 59,349,504 shares of our non-voting preferred shares in an international offering and are offering 7,712,082 preferred shares in a Brazilian offering. Each ADS represents four preferred shares. We will not receive any of the proceeds from the sale by the selling shareholders of the ADSs and the preferred shares.

Our ADSs are listed on the New York Stock Exchange under the symbol "ERJ." On June 12, 2001, the last reported sales price of our ADSs on the New York Stock Exchange was $38.90 per ADS.

Investing in the ADSs involves risks. See "Risk Factors" beginning on page 11.

PRICE $38.90 AN AMERICAN DEPOSITARY SHARE

	Price to Public	Underwriting Discounts and Commissions	Proceeds to Selling Shareholders
Per ADS	$38.90	$.9239	$37.9761
Total	$577,173,926	$13,708,252	$563,465,674

The selling shareholders have granted the international and Brazilian underwriters the right to purchase up to an additional 10,059,236 preferred shares, including preferred shares in the form of ADSs, to cover over-allotments.

The Securities and Exchange Commission and state securities regulators have not approved or disapproved these securities, or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

Morgan Stanley & Co. Incorporated expects to deliver the American Depositary Receipts representing the ADSs to purchasers on June 19, 2001.

MORGAN STANLEY DEAN WITTER

CREDIT SUISSE FIRST BOSTON MERRILL LYNCH & CO.

June 12, 2001

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You should rely only on the information contained in this prospectus or to which we have referred you. We have not authorized anyone to provide you with information that is different. This document may only be used where it is legal to sell the ADSs and the preferred shares. The information in this document is only accurate at the date of this prospectus, and our business, results of operations and financial condition may change after the date of this prospectus.

In this prospectus, ''Embraer,'' ''we,'' ''our'' and ''us'' refer to Embraer-Empresa Brasileira de Aeronáutica S.A. and its consolidated subsidiaries (unless the context otherwise requires). Unless otherwise specified, share amounts in this prospectus do not reflect the exercise of the underwriters' over-allotment option.

We have prepared this prospectus on the basis of information that we have or have obtained from sources we believe to be reliable. The discussions of documents referred to in this prospectus summarize those documents and we refer you to the documents for more complete information. You should consult your own legal, tax and business advisors regarding an investment in the ADSs.

We have not taken any action to permit a public offering of the ADSs outside the United States or to permit the possession or distribution of this prospectus outside the United States. Persons outside the United States who come into possession of this prospectus must inform themselves about and observe any restrictions relating to the offering of ADSs and the distribution of this prospectus outside of the United States.

No offer or sale of ADSs may be made to the public in Brazil except in circumstances which do not constitute a public offer or distribution under Brazilian laws and regulations. Any offer or sale in Brazil to non-Brazilian residents may be made only under circumstances that do not constitute a public offer or distribution under Brazilian laws and regulations.

We are a joint stock company duly incorporated under the laws of Brazil with unlimited duration. We have the legal status of a *sociedade por ações,* a corporation with limited liability, operating under the Brazilian corporation law.

PROSPECTUS SUMMARY

The following is a summary of our business, our financial information and this offering of ADSs. You should read this entire prospectus, including the information set forth in ''Risk Factors'' and our financial statements and the notes thereto, before making an investment decision.

EMBRAER-EMPRESA BRASILEIRA DE AERONÁUTICA S.A.

We are the fourth largest manufacturer of commercial aircraft in the world based on 2000 net sales of commercial aircraft, with a global customer base that includes Continental Express, Crossair, American Eagle and other regional airlines in the United States, Europe and Brazil. We focus primarily on manufacturing regional aircraft, which accounted for 88.9% of our net sales in 2000. At March 31, 2001, we had captured approximately 33% of the regional jet market worldwide and approximately 47% of the 20-59 seat regional jet market worldwide (based on aircraft delivered and firm orders in backlog). 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 are developing a new line of corporate jets based on one of our regional jets. We were Brazil's largest exporter in both 1999 and 2000. For the year ended December 31, 2000, we generated net sales of R$5,417.5 million, of which approximately 94% was U.S. dollar-denominated and approximately 4% was euro-denominated, and net income before income tax benefit (provision), net non-operating income (expense), net financial income (expenses), depreciation and amortization and minority interest, or EBITDA, of R$1,060.6 million. For the definition of EBITDA, see note 6 of ''Selected Financial and Other Data.'' For the three months ended March 31, 2001, we generated net sales of R$1,538.6 million, of which approximately 93% was U.S. dollar-denominated and approximately 5% was euro-denominated, and EBITDA of R$455.4 million. At March 31, 2001, we had a total backlog in orders of US$11.1 billion, equivalent to R$24.1 billion, including 564 regional jets.

Regional Aircraft Business

We design, develop and manufacture a range of regional aircraft, including:

- the ERJ 145, a 50-passenger regional jet;
- the ERJ 135, a 37-passenger regional jet based on the ERJ 145; and
- the EMB 120 Brasília, a 30-passenger pressurized twin turboprop aircraft.

In September, 2000, we announced the launch of a new regional jet as part of the ERJ 135/145 regional jet family, the 44-seat ERJ 140, which we expect to deliver in the second half of 2001. We have sold the ERJ 145, ERJ 140 and ERJ 135 to 28 customers worldwide. At March 31, 2001, we had a backlog of 234 ERJ 145s, 139 ERJ 140s and 71 ERJ 135s. Our regional aircraft business accounted for 88.9% of our net sales for the year ended December 31, 2000 and 90.2% of our net sales for the three months ended March 31, 2001. We recognize revenue for the sale of our regional aircraft when the aircraft is delivered to the customer.

We are currently developing a new regional jet family to serve the trend in the regional aircraft market toward larger, faster and longer-range regional jets and to expand our presence in the regional jet market. This regional jet family will be comprised of the ERJ 170, the ERJ 190-100 and the ERJ 190-200. The ERJ 170 will be a 70-passenger regional jet, while the ERJ 190 series will include the 98-passenger ERJ 190-100 and the 108-passenger ERJ 190-200. We expect to commence deliveries of the ERJ 170 in late 2002, the ERJ 190-200 in mid-2004 and the ERJ 190-100 in 2005. At March 31, 2001, we had 120 firm orders for the ERJ 170/190 regional jet family. We are developing the ERJ 170 and ERJ 190 series together with risk-sharing partners, including General Electric Co. and Honeywell, Inc., which will supply key systems for these aircraft. Risk-sharing partners contribute their own funds to research and develop the components used in our regional aircraft, thereby reducing our development costs. Our risk-sharing partners will contribute to us a total of US$256 million in cash, of which we have already received US$145.8 million as of March 31, 2001.

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 the military forces of 16 other countries in Europe and Latin America, including the United Kingdom, France, Greece and Mexico. At March 31, 2001, we had sold 514 defense aircraft to the Brazilian government and 520 defense aircraft to other military forces. Our defense business accounted for 3.4% of our net sales for the year ended December 31, 2000 and 2.9% of our net sales for the three months ended March 31, 2001. Of defense net sales, sales to the Brazilian government accounted for 70.5% in 2000 and 67.6% for the three months ended March 31, 2001.

Corporate Jet Business

We are developing a new line of corporate jets, the Legacy, based on our ERJ 135 regional jet. We are marketing the new Legacy to businesses, including fractional ownership companies. At March 31, 2001, we had 30 firm orders and 31 options for the Legacy, including 25 firm orders and 25 options from our launch customer Swift Aviation Services, Inc., a fractional ownership company. Our corporate jet business accounted for 1.0% of our net sales for the year ended December 31, 2000, resulting from the delivery of two ERJ 135s to the corporate market, as compared to no corporate jet deliveries for the three months ended March 31, 2001.

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 6.8% of our net sales for the year ended December 31, 2000 and 6.9% of our net sales for the three months ended March 31, 2001.

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 20% of all the outstanding common stock of Embraer from our existing common shareholders, a majority of which was from our controlling shareholders. We believe that our strategic alliance with the European Aerospace and Defense Group will help us to increase our technological capabilities and to market innovative defense products. We also believe that the alliance will allow us to grow our business substantially in the future by providing us access to a broader customer base for our regional and defense aircraft as well as access to customer support facilities of the European Aerospace and Defense Group.

Regional Aircraft Industry

Regional airlines have experienced significant growth over the past decade, primarily in the United States and Europe. We believe that substantial worldwide growth in the regional airline market over the next decade, especially in the United States and Europe, combined with a strong passenger preference for jet aircraft service on regional flights and greater nautical mile range for regional aircraft, will significantly increase the demand by regional airlines for low-cost, high-performance regional jet aircraft.

According to a report by Stanford Transportation Group LLC and AvStat Associates, published on February 27, 2001 in *Commuter/Regional Airline News*, which we refer to as the Stanford/AvStat Report, a total of 853 regional turboprop and 3,787 regional jet deliveries in the 20-110 seat regional airline fleet are expected worldwide between 2001 and 2010. The U.S. Federal Aviation Administration, or FAA, forecasts U.S. revenue passenger miles to grow at an average annual rate of 7.3% over the 12-year period ending 2012, up from 22.3 billion in 2000 to 52.1 billion in 2012, and the number of passengers flown to grow by an average annual rate of 5.6% during the same period reaching a total of 153.7 million passengers in 2012.

Our Strengths

We believe that our primary strengths include the following:

- We are a leading regional jet manufacturer with a global customer base;
- We offer our aircraft at competitive prices and produce aircraft with reduced operating costs due to the similarity in design and commonality of aircraft parts within a regional jet family. The flexibility of our regional jet families also enables us to cost-effectively develop new products to meet specific customer needs and to target new markets;
- We have strategic relationships with risk-sharing partners which contribute their own funds to research and develop the components used in our regional jet aircraft, thereby reducing our development costs;
- Our management team focuses on developing new products, aggressively marketing our products internationally, enhancing customer service with on-site and regional customer support and regionally based inventory distribution, and increasing operating efficiency; and
- We benefit from the funding by the Brazilian government of our research and development costs related to defense aircraft and are able to apply the technological developments we acquire from our defense technology to our commercial business.

Our strengths must be evaluated against the challenges we face, including that we are a Brazilian company and as such are subject to risks associated with the Brazilian economic environment, and that some of our global competitors are larger and have greater financial resources than we do.

Business Strategies

The principal components of our business strategies include the following:

- Develop our new 70-108 seat regional jet family to meet the growing demand for larger regional jets;
- Develop our strategic alliance with the European Aerospace and Defense Group to expand our customer base, enhance our technological capabilities, increase our production and marketing of innovative defense products, and take advantage of synergies between our respective sales and service forces for regional jets;
- Increase our focus on customer support;
- Increase operating efficiencies and production capacity;
- Expand our risk-sharing arrangements in order to reduce production costs and streamline the management of our suppliers;

- Increase our penetration into the defense market by developing and marketing additional defense products and actively marketing our existing products initially developed for the Brazilian Air Force in the international defense market;
- Develop a line of corporate jets to provide businesses, including fractional ownership companies, with a cost-effective alternative to commercial regional airline travel; and
- Pursue strategic growth opportunities to expand our business or enhance our products and technology.

Our strategies are subject to many risks described under ''Risk Factors,'' which you should read carefully. Brazilian political and economic conditions have had, and will continue to have, a direct impact on our business. The Brazilian economy has been characterized by volatile economic cycles and by frequent and occasionally drastic intervention by the Brazilian government. Uncertainty in the Brazilian economy may hinder our ability to implement our strategies as planned.

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 55-12-345-1106. We maintain an Internet site at www.embraer.com. Information contained on our Internet site is not a part of this prospectus.

THE OFFERINGS

Selling shareholders in the international offering	Bozano Holdings Ltd.; Fundação SISTEL de Seguridade Social, also known as SISTEL; Caixa de Previdência dos Funcionários do Banco do Brasil—PREVI, also known as PREVI; and BNDES Participações S.A.—BNDESPAR, also known as BNDESPAR, a wholly owned subsidiary of Banco Nacional de Desenvolvimento Econômico e Social —BNDES, the Brazilian National Economic and Social Development Bank, also known as BNDES.
Selling shareholders in the Brazilian offering	Cia. Bozano, SISTEL, PREVI and BNDESPAR.
International offering	14,837,376 ADSs are being offered through the international underwriters in the United States and in other countries outside of Brazil.
Brazilian offering	7,712,082 preferred shares are being offered in a public offering in Brazil in accordance with Brazilian law.
Outstanding capital stock	The number of common shares and preferred shares of Embraer outstanding, including preferred shares in the form of ADSs, is set forth below:

Common shares	242,544,448
Preferred shares	374,803,426
Total shares outstanding	617,347,874

Use of proceeds	We will not receive any proceeds from the sale of ADSs and preferred shares in connection with the international and Brazilian offerings.
Over-allotment option	The selling shareholders have granted the international and Brazilian underwriters an option to purchase an additional 10,059,236 preferred shares, including preferred shares in the form of ADSs, within 30 days from the date of this prospectus, solely to cover over-allotments, if any.
The ADSs	Each ADS will represent four preferred shares.
Voting rights	Holders of the preferred shares and, consequently, holders of ADSs do not have voting rights except in limited circumstances. See "Description of Capital Stock—Voting Rights of the Preferred Shares."
Liquidation preference	In the event we are liquidated, you will have priority over the common shares in the return of capital in proportion to your share of our net worth, once all our creditors have been paid.
Dividends	Under the Brazilian corporation law, we are required to distribute as dividends not less than 25% of our net income, subject to adjustments and exceptions. You will be entitled to receive dividends in an amount per share that is 10% more than the amount per share paid to holders of our common shares. See "Description of Capital Stock" and "Dividends and Dividend Policy." You are entitled to receive dividends to the same extent as holders of preferred shares underlying

	the ADSs, subject to the deduction of any fees and charges of the depositary. See "Description of American Depositary Shares."
Taxation	Dividend distributions of profits generated after January 1, 1996 with respect to ADSs or preferred shares are not currently subject to withholding of Brazilian income tax. Gains from the sale or other disposition of ADSs outside of Brazil among individuals or corporations not domiciled in Brazil will not be subject to Brazilian income tax. For a description of the Brazilian tax consequences arising from the sale or other disposition of preferred shares, see "Taxation Brazilian Tax Consequences—Taxation of Gains." For U.S. tax considerations with respect to purchasing, holding or disposing of ADSs or preferred shares, see "Taxation—U.S. Federal Income Tax Consequences."
New York Stock Exchange symbol . .	ERJ
Concurrent offering of exchangeable notes	Concurrently with this offering, BNDES is offering exchangeable notes in a private offering to qualified institutional buyers in reliance upon Rule 144A under the Securities Act of 1933, as amended, and outside the United States in reliance upon Regulation S under the Securities Act. These notes will be exchangeable at any time prior to their maturity at the option of the holders for ADSs representing preferred shares currently owned by BNDESPAR, at an exchange ratio of 21.2450 ADSs per US$1,000 principal amount of notes, subject to adjustment. If all the exchangeable notes (including notes issued pursuant to the exercise of an over-allotment option) were exchanged for ADSs, BNDESPAR's holdings of our preferred shares would be reduced by 25,494,000 preferred shares.

Unless we state otherwise, the number of shares of our capital stock outstanding after this offering and the Brazilian offering (using the actual number of shares outstanding as of June 11, 2001) excludes 19,950,000 preferred shares issuable upon the exercise of outstanding stock options held by employees of Embraer. Unless we state otherwise, the shareholdings of BNDESPAR are not adjusted to give effect to the concurrent exchangeable note offering by BNDES.

SUMMARY FINANCIAL AND OTHER DATA

The following table presents our summary financial and other data at the dates and for each of the periods indicated. The summary financial data at December 31, 1998, 1999 and 2000 and for the years ended December 31, 1998, 1999 and 2000 are derived from our financial statements audited by Arthur Andersen S/C, independent public accountants, included elsewhere in this prospectus.

Our financial statements have been restated using the constant currency method to recognize effects of changes in the purchasing power of the Brazilian currency due to inflation and expressed in constant *reais* of March 31, 2001 purchasing power using the *Índice Geral de Preços do Mercado*, or the General Market Price Index, which is published by the *Fundação Getúlio Vargas*—FGV, an independent economic research organization. However, because we believe that the effects of inflation during 1998, at the rate of 1.8% based on the General Market Price Index, are not material to the presentation of our financial information, we have assumed an annual inflation rate of 0% for 1998 for purposes of applying the constant currency method.

The summary financial data at and for the three months ended March 31, 2000 and 2001 have been derived from our unaudited interim financial statements included elsewhere in this prospectus, which, in the opinion of management, reflect all adjustments which are of a normal recurring nature necessary for a fair presentation of the results for such periods. The results of operations for the three months ended March 31, 2001 are not necessarily indicative of the operating results to be expected for the entire year ended December 31, 2001. For convenience only, Brazilian currency amounts for the three months ended March 31, 2001 have been converted into U.S. dollars at a rate of R$2.1616 to US$1.00, the commercial selling rate at March 31, 2001.

The financial data from which the summary financial data presented herein are derived have been prepared in accordance with Brazilian GAAP, which differs in significant respects from U.S. GAAP. You should read this data in conjunction with our audited and unaudited financial statements and the notes thereto included elsewhere in this prospectus, as well as ''Presentation of Financial and Other Data,'' ''Selected Financial and Other Data'' and ''Management's Discussion and Analysis of Financial Condition and Results of Operations.''

	At and for the year ended December 31,			At and for the three months ended March 31,		
	1998	1999	2000	2000	2001	2001
	(in thousands, except per share/ADS data)					
Income Statement Data:						
Brazilian GAAP						
Net sales	R$2,104,569	R$4,059,797	R$5,417,476	R$ 1,140,113	R$1,538,588	US$711,782
Gross profit	540,225	1,403,416	1,501,538	292,517	572,189	264,706
Selling and administrative expenses	(240,945)	(359,294)	(522,752)	(105,156)	(153,416)	(70,973)
Income from operations before financial income (expenses)	236,894	1,001,438	843,199	158,225	395,308	182,877
Financial income (expenses), net	(107,292)	(458,619)	(84,989)	3,317	(122,307)	(56,582)
Income tax benefit (provision)	(15,689)	25,436	(256,594)	(67,712)	(76,113)	(35,211)
Net income	108,778	509,280	512,665	94,134	191,895	88,775
Net income per share(1)(2)	.23	1.05	.94	.20	.35	.16
Net income per ADS(1)(2)	.92	4.20	3.76	.80	1.40	.64
Cash dividends per common share(2)(3)	.11	.24	.50	.03	.05	.02
Cash dividend per preferred share(2)(3)	.12	.27	.55	.04	.06	.03
Cash dividend per ADS(2)(3)	.48	1.08	2.20	.14	.22	.10
Cash dividends per ADS (in U.S. dollars)(4)	US$ .48	US$ .91	US$ 1.13	US$ .12	US$ .10	US$ .10
Weighted average number of common shares outstanding(2)	242,544	242,544	242,544	242,544	242,544	242,544
Weighted average number of preferred shares outstanding(2)	238,673	238,673	270,028	242,612	300,865	300,865

	At and for the year ended December 31,			At and for the three months ended March 31,		
	1998	1999	2000	2000	2001	2001
	(in thousands, except per share/ADS data)					
U.S. GAAP						
Net sales	R$2,104,569	R$4,059,797	R$5,417,476			
Gross profit	633,991	964,508	1,681,349			
Selling and administrative expenses	(240,973)	(355,860)	(516,155)			
Income from operations before financial income (expenses)	259,999	502,750	935,036			
Financial income (expenses), net	(62,399)	64,972	(116,919)			
Net income	208,199	491,982	539,611			
Net income per common share—basic(1)(2)	.41	.97	1.00			
Net income per common share—diluted(1)(2)	.41	.83	.85			
Net income per preferred share—basic(1)(2)	.45	1.07	1.10			
Net income per preferred share—diluted(1)(2)	.44	.91	.93			
Net income per ADS—basic(1)(2)	1.80	4.28	4.40			
Net income per ADS—diluted(1)(2)	1.76	3.64	3.72			
Balance Sheet Data:						
Brazilian GAAP						
Cash and cash equivalents	R$ 420,375	R$ 611,255	R$2,358,602	R$ 723,995	R$2,527,916	US$1,169,465
Total assets	3,022,707	4,320,238	5,534,427	4,219,567	6,217,518	2,876,350
Property, plant and equipment	460,810	521,769	673,923	528,029	710,212	328,558
Total debt	1,092,213	1,269,233	906,948	1,121,288	908,158	420,132
Total liabilities	2,314,956	3,260,728	3,772,757	3,066,294	4,296,136	1,987,480
Shareholders' equity	707,751	1,059,510	1,761,670	1,153,273	1,921,382	888,870
U.S. GAAP						
Total assets	R$2,545,706	R$3,968,804	R$5,235,096			
Property, plant and equipment	167,442	389,898	548,401			
Total debt	1,092,213	1,269,233	906,948			
Total liabilities	2,293,400	3,194,748	3,698,603			
Shareholders' equity	252,306	774,056	1,536,493			
Other Financial Data:						
Brazilian GAAP						
Depreciation and amortization	R$ 151,900	R$ 185,615	R$ 217,427	R$ 51,128	R$60,057	US$27,784
Capital expenditures	117,369	143,695	328,589	32,000	90,617	41,921
Net cash provided by operating activities	26,027	432,066	2,058,731	219,959	408,446	188,955
Net cash provided by (used in) financing activities	377,029	(99,741)	13,862	(75,277)	(146,474)	(67,762)
Net cash used in investing activities	(122,553)	(141,445)	(325,249)	(31,943)	(92,658)	(42,865)
EBITDA(5)	388,794	1,187,053	1,060,626	209,353	455,365	210,661
U.S. GAAP						
Depreciation and amortization	R$ 56,703	R$ 69,730	R$ 70,007			
Capital expenditures	56,123	152,215	229,565			
Net cash provided by (used in) operating activities	(63,765)	440,586	1,978,358			
Net cash provided by (used in) financing activities	405,577	(99,741)	1,026			
Net cash used in investing activities	(61,307)	(149,965)	(232,039)			
EBITDA(5)	316,702	572,480	1,005,043			

	At and for the year ended December 31,			At and for the three months ended March 31,	
	1998	1999	2000	2000	2001
Other Data:					
Aircraft delivered during period:					
To the Regional Market					
EMB 120 Brasília	13	7	—	—	—
ERJ 145	60	80	112	24	28
ERJ 135	—	16	45	10	14
To the Defense Market					
EMB 120 Brasília	1	—	—	—	—
ERJ 135	—	—	1	1	—
EMB 312 Tucano	6	—	—	—	—
AM-X	10	3	1	—	—
To the Corporate Market					
Legacy(6)	—	—	2	—	—
To the General Aviation Market					
Light aircraft	26	17	17	2	2
Total delivered	116	123	178	37	44
Aircraft ordered during period:					
In the Regional Market					
EMB 120 Brasília	20	—	2	—	—
ERJ 145	64	125	197	86	1
ERJ 135	126	6	6	24	—
ERJ 140	—	—	133	—	6
ERJ 170	—	40	50	—	—
ERJ 190-200	—	30	—	—	—
In the Defense Market					
EMB 120 Brasília	1	—	—	—	—
EMB 145 AEW&C	—	4	—	—	1
EMB 145 MP	—	—	—	—	2
ERJ 145	—	—	2	—	—
ERJ 135	—	1	2	—	—
In the Corporate Market					
Legacy(6)	—	—	31	—	1
In the General Aviation Market					
Light aircraft	26	19	15	—	2
Total firm orders received	237	225	438	110	13
Aircraft in backlog at the end of period:					
In the Regional Market					
EMB 120 Brasília	7	—	2	—	2
ERJ 145	131	176	261	238	234
ERJ 135	134	124	85	139	71
ERJ 140	—	—	133	—	139
ERJ 170	—	40	90	40	90
ERJ 190-200	—	30	30	30	30
In the Defense Market					
EMB 145 AEW&C	5	9	9	9	10
EMB 145 RS	3	3	3	3	3
EMB 145 MP	—	—	—	—	2
AM-X	4	1	—	—	—
ERJ 145	—	—	2	—	2
ERJ 135	—	1	2	—	2
In the Corporate Market					
Legacy	—	—	29	—	30
In the General Aviation Market					
Light Aircraft	—	2	—	—	—
Total backlog (in aircraft)	284	386	646	459	615
Total backlog (in millions)	US$4,112	US$6,365	US$11,421	US$ 7,654	US$11,137

(1) Based on total number of common shares and preferred shares outstanding at the end of the period under Brazilian GAAP and on a weighted average number of shares outstanding under U.S. GAAP. See note 30 to our audited financial statements.

(2) 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.

(3) Includes interest on shareholders' equity. Shown in nominal *reais*.

(4) 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.

(5) EBITDA means net income before income tax benefit (provision), net non-operating income (expense), net financial income (expenses), depreciation and amortization and minority interest. EBITDA is a non-U.S. GAAP and a non-Brazilian GAAP measurement that does not represent cash flow for the periods presented and should not be considered as an alternative to net income (loss), as an indicator of our operating performance or as an alternative to cash flows as a source of liquidity. Our EBITDA (as defined above) may not be comparable with EBITDA as defined by other companies. Although EBITDA (as defined above) does not provide a U.S. or Brazilian GAAP measure of operating cash flows, it is commonly used by financial analysts and others in the aerospace industry.

(6) Includes two ERJ 135s for the corporate market.

RISK FACTORS

You should carefully consider the risks described below before making an investment decision. In general, investing in securities of issuers in emerging markets such as Brazil involves more risk than investing in the securities of an issuer located in the United States. If any of the following risks and uncertainties develop into actual events, our business, financial condition or results of operations could be materially adversely affected. In such case, the trading price of our ADSs could decline, and you may lose all or part of your investment.

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 growth in the near future will be derived from sales of regional aircraft, particularly the ERJ 135/140/145 regional jet family. Historically, the market for regional aircraft has been cyclical due to a variety of factors which are both external and internal to the air travel industry, including general economic conditions. A downturn in general economic conditions could result in a reduction in the passenger aircraft market and decrease orders for our regional aircraft. If an airline or another of our customers experiences a business downturn, cannot obtain financing or otherwise seeks to limit its capital expenditures, that airline or customer could defer or cancel its purchase of our regional aircraft or change its operating requirements. Under these circumstances, we would not be able to rely solely on sales of our other products to offset a reduction in sales of our regional aircraft. Delays or decreases in the number of regional aircraft delivered in any year could reduce our sales and revenue, and consequently our profitability, for that year.

We depend on a small number of key customers, the loss of any of which could reduce our sales and reduce our market share.

Commercial aircraft. We rely on a limited number of customers for a substantial portion of our total net sales. Our largest customers are Continental Express, Crossair and American Eagle. At March 31, 2001, 63.7% of our firm orders in backlog and 37.0% of our options for the ERJ 145 were attributable to Continental Express and American Eagle. At the same date, 35.2% of our firm orders in backlog for the ERJ 135 were from Continental Express. At March 31, 2001, all of our firm orders and options for the ERJ 140 were from American Eagle. Crossair, the launch customer of the ERJ 170/190 regional jet family, and GE Capital Aviation Services represent 91.7% of firm orders in backlog and 97.6% of options for the ERJ 170/190 regional jet family at March 31, 2001. In addition, at March 31, 2001, 83.3% of our firm orders in backlog and 80.6% of our options for the Legacy, our new line of corporate jets, were from Swift Aviation Services. Although we have diversified our customer base over the last four years and expect to continue to do so, 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 and a smaller market share could also reduce our profitability.

Defense aircraft. The Brazilian Air Force is our largest customer of defense aircraft products. Sales to the Brazilian government accounted for 70.5% of our defense sales for the year ended December 31, 2000 and 67.6% of our defense sales for the three months ended March 31, 2001. 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.

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 April 1999, the World Trade Organization, or 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. The WTO ruled that Brazil must withdraw the prohibited portions of its export subsidies for regional aircraft under the ProEx program and recommended that it conform the ProEx program to the WTO rules by November 18, 1999. On November 19, 1999, the Brazilian and Canadian governments presented to the dispute resolution body of the WTO the modifications that they made to bring their respective programs into compliance with the WTO rulings. Both countries then declared that the other's modifications were unsatisfactory and did not comply with the WTO rulings.

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 still decreased effective interest rates for regional aircraft to below commercial market levels and thus continued to provide a prohibited export subsidy. The Brazilian government publicly announced that it intends to honor its contractual commitments to our customers. However, we cannot assure you that the Brazilian government will, in fact, honor its contractual commitments to our customers, or that, if it does, its trade relations with Canada or other countries will not suffer. The Brazilian government also announced that it would further amend the ProEx program to provide that any ProEx payments would not decrease the effective interest rate below the commercial interest reference rate permitted by the WTO regulations without proof that the actual market interest rate is lower than the commercial interest reference rate. Canada is challenging the Brazilian government's interpretation of the scope of application of the WTO's effective interest rate restrictions.

A substantial percentage of our customers benefit from the ProEx program. A reduction of existing commitments under the ProEx program could cause us to reduce prices or otherwise compensate our customers or could result in the cancellation of firm orders in backlog, which could reduce our sales and profitability. 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.

As a result of Brazil's decision to maintain its contractual commitments under the ProEx program, the WTO dispute settlement body granted Canada 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 any such sanctions will adversely affect our business. In addition, the Canadian government has 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. Brazil is challenging this financing before the WTO. If the WTO determines that these or any other government-sponsored financing that benefits our competitors is permissible, the cost-competitiveness of our aircraft in the regional jet market would suffer. For further information on the ProEx program and the WTO proceeding, see "Business—Aircraft Financing Arrangements."

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 March 31, 2001, approximately 31.6% 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. See ''Management's Discussion and Analysis of Financial Condition and Results of Operations—Overview'' for a discussion of these arrangements. 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 our growth, which could lead to delays in deliveries of our aircraft or other disruptions in our business.

Significant growth in our backlog and our planned increase in monthly aircraft deliveries may present us with substantial management and production challenges. We will need to increase production capacity from 16 aircraft per month at March 31, 2001 to 20 aircraft per month by the end of 2001 in order to meet expected peak deliveries of the ERJ 135/140/145 regional jet family. In addition, for the ERJ 170/190 regional jet family, we will have to continue constructing new production facilities, hiring new employees, reallocating existing resources and coordinating with new suppliers and risk-sharing partners. There could be conflicts between the production schedules of the ERJ 135/140/145 regional jet family and the ERJ 170/190 regional jet family, which we expect to begin delivering in late 2002. These scheduling conflicts could lead to delays in deliveries.

We also need to recruit, retain and motivate additional highly skilled employees to meet future customer demand. 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 attract and retain skilled personnel could impede our development efforts and cause delays in production and deliveries of our aircraft. Because we record revenue from the sale of a new aircraft at delivery, a delay in the delivery of new aircraft would also mean a delay in the recognition of revenue from that aircraft.

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 the 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 have had net losses for eleven out of the past fourteen years, and our recent profitability is no assurance of future profitability.

We had net losses for each of the eight fiscal years before our privatization in 1994. Since our privatization, we had net losses of R$460.0 million in 1995, R$89.6 million in 1996 and R$13.0 million in 1997. Prior to 1996, we also had operating losses. We had net income of R$108.8 million, R$509.3 million and R$512.7 million for the years ended December 31, 1998, 1999 and 2000 and net income of R$191.9 million for the three months ended March 31, 2001. The continuation of our operations and our ability to manufacture profitably aircraft and aircraft components depends to a large extent on the success of measures that our management has taken and continues to take toward stabilizing our financial position and maintaining profitability. We cannot assure you that we will continue to operate profitably in the future.

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

We estimate that the total amount necessary to develop the ERJ 170/190 regional jet family will be approximately US$858 million. Of that amount, our capital expenditures will be approximately US$568 million. To cover part of our capital expenditures, our risk-sharing partners will contribute to us a total of US$256 million in cash, of which we have already received US$145.8 million as of March 31, 2001. If we cancel the development and production of the ERJ 170/190 regional jet family because we are unable to obtain certification for the aircraft or for other non-market related reasons, then we may be obligated to refund up to the full amount of the cash contributions. If we require additional financing and we are unable to obtain it, we will not be able to develop and market our ERJ 170/190 regional jet family. See ''Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources'' for a more detailed discussion of our funding sources and requirements.

Our aircraft sales are subject to cancellation provisions, repurchase and trade-in options and residual value guarantees in favor of our customers 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.

A substantial number of cancellations could reduce our sales and revenue for a given year, which in turn would reduce our cash flow.

We also may have to repurchase a number of our aircraft. The price per aircraft of any required repurchase is less than the original purchase price of the aircraft and less than our current estimate of the market value of the relevant aircraft type in future years (based on current third-party appraisals of the same type of aircraft). 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 these third-party appraisals, we believe that we could sell any repurchased aircraft in the market for a price at least equal to the repurchase price.

At March 31, 2001, approximately 5% of our firm orders for regional jets, including aircraft that have already been delivered, were subject to trade-in options. These options provide that the repurchase price can be applied to the price of an upgraded model or any of our other aircraft. The repurchase 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 repurchase prices that are above the then-market price of the aircraft, which would result in a financial loss for us when we resell the aircraft.

We also have guaranteed the minimum residual value of some of our aircraft that have already been delivered. These guarantees run in favor of some of our customers or providers of financing to our customers. These minimum residual values do not exceed our current estimates of the market value of the relevant aircraft types in future years (based on current third-party appraisals of the same type of aircraft). Our guarantees typically ensure that in the 15th year after the year of delivery, the relevant aircraft will have a minimum residual value of 18% to 25% of the original sale price. We may also be called upon to guarantee the minimum residual value of other aircraft that have not yet been delivered. We may be obliged to make substantial payments in the event that actual residual values of the relevant aircraft decline below the guaranteed levels.

If we are required to honor the relevant repurchase obligation or the guarantee of the minimal residual value, 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 financing will be available to us at that time, on satisfactory terms or at all. We also cannot assure you that, upon repurchase, then-prevailing market conditions would allow us to resell the repurchased aircraft at approximately the same cost or in a timely manner. Consequently, honoring our repurchase obligations, trade-in options or guarantees of minimal residual value could require us to make significant cash disbursements in a given year, which in turn would reduce our cash flow in that year.

Our backlog may be reduced by customer cancellations, which would have a negative effect on our future sales.

At March 31, 2001, we had a total backlog of US$11.1 billion. Although there are generally varying penalties for canceling orders or delaying deliveries, firm orders may be canceled or deliveries rescheduled by our customers, particularly during an economic downturn in the United States, Europe or elsewhere. Any delay in delivery during any period could have a material adverse effect on our sales and profitability for that period. Cancellation of one or more firm orders could have a material adverse effect on our future sales and profitability.

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

The worldwide regional jet aircraft manufacturing industry is highly competitive. We are the fourth largest manufacturer of commercial aircraft in the world, behind 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. See ''—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 more complete discussion of these export subsidies. In addition, other major international aircraft manufacturers, including The Boeing Company and Airbus Industrie, have produced or have plans to produce aircraft at the high end of the 81-110 seat segment, increasing the competitive pressures in the market. These companies also have significant technological capabilities and 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 has announced that initial delivery of its 70-seat regional jet will occur prior to the initial deliveries of the ERJ 170/190. 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. Some of our competitors, unlike us, accept trade-ins of used aircraft for new aircraft in the ordinary course of business, a practice that could enhance their marketability. We cannot assure you that we will be able to compete successfully in our markets in the future. See ''Business—Regional Aircraft Business—Competition'' for a more complete discussion of our competitors.

We may have to make significant payments as a result of unfavorable outcomes of pending litigation.

We have a number of labor-related lawsuits brought by the workers' union representing some of our former employees with claims in an aggregate amount of approximately R$85.7 million at March 31, 2001, for which we had provisioned approximately R$15.3 million at such date. Our management considers these amounts to represent a reasonable estimate of future payment on settlement or resolution of these lawsuits. We also 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 cannot assure you that we will prevail in any of these lawsuits or that the amount provisioned will be sufficient to cover future judgments against us.

A lawsuit brought in October 1992 by the workers' union on behalf of 7,283 current and former employees is currently pending in the Superior Labor Court, Brazil's highest appellate court for labor disputes. The plaintiffs are seeking payment of salary differences based on existing agreements between the labor unions and the *Federação das Indústrias do Estado de São Paulo*, or the Industry Federation of the State of São Paulo, also known as FIESP. The total exposure for payment of retroactive salaries was R$62.0 million on March 31, 2001. At March 31, 2001, we had not provisioned any amounts for this lawsuit, because we believe that this lawsuit is not likely to result in a decision adverse to us. We expect final judgment to occur by the second half of 2001. We cannot assure you that we will prevail in this lawsuit.

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. Although these scope clauses are expected to be renegotiated in the years 2001 through 2003, we cannot assure you that those restrictions will be lessened, or that the current restrictions will not be further tightened, 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 repairs 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

The Brazilian government has exercised, and continues to exercise, significant influence over the Brazilian economy. Brazilian political and economic conditions have a direct impact on our business and the market price of the preferred shares and the ADSs.

The Brazilian government frequently intervenes in the Brazilian economy and occasionally makes drastic changes in policy. The Brazilian government's actions to control inflation and effect other policies have often involved wage and price controls, currency devaluations, capital controls and limits on imports, among other things. See ''Management's Discussion and Analysis of Financial Condition and Results of Operations—Brazilian Economic Environment.'' Our business, financial condition and results of operations 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:

- currency fluctuations;
- inflation;
- price instability;
- interest rates;
- tax policy;
- energy shortages; and
- other political, diplomatic, social and economic developments in or affecting Brazil.

The Brazilian government's actions to maintain economic stability as well as public speculation about possible future actions 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 and governmental measures to combat inflation have in the past had significant negative effects on the Brazilian economy. Inflation, actions taken to combat inflation and public speculation about possible future actions have also contributed to economic uncertainty in Brazil and to heightened volatility in the Brazilian securities markets. See ''Management's Discussion and Analysis of Financial Condition and Results of Operations—Effects of Inflation and Currency Exchange Fluctuations'' for a discussion of these effects on our financial condition and results of operations.

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.

Fluctuations in the value of the real against the value of the U.S. dollar 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. See ''Management's Discussion and Analysis of Financial Condition and Results of

Operations—Effects of Inflation and Currency Exchange Fluctuations'' for a discussion of these effects on our financial condition and results of operations.

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.

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 emerging market countries may affect the market price of the preferred shares and the ADSs and may make it more difficult or expensive for us to obtain additional debt financing.

Securities of Brazilian issuers have been, to varying degrees, influenced by economic and market conditions in other 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 current recession in Argentina, 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. The market value of the preferred shares and the ADSs, as well as our ability to obtain additional debt financing on acceptable terms or at all, may be adversely affected by events elsewhere, especially in emerging market countries.

Risks Relating to the Preferred Shares and the ADSs

Restrictions on the movement of capital out of Brazil may hinder your ability to receive dividends and distributions on, and the proceeds of any sale of, the preferred shares.

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. Brazilian law permits the government to impose these restrictions whenever there is a serious imbalance in Brazil's balance of payments or there are reasons to foresee a serious imbalance.

The Brazilian government imposed remittance restrictions for approximately six 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. In such a case, the depositary for the ADSs will hold the *reais* it cannot convert for the account of the ADR holders who have not been paid. The depositary will not invest the *reais* and will not be liable for interest on those amounts.

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

The Brazilian custodian for the preferred shares must obtain an electronic certificate of registration from the Central Bank of Brazil, or the Central Bank, to be entitled to remit U.S. dollars abroad for payments of dividends and other distributions relating to the preferred shares or upon the disposition of the preferred shares. If you decide to exchange your ADSs for the underlying preferred shares, you will be entitled to continue to rely—for five business days from the date of exchange—on the custodian's electronic certificate of registration. Thereafter, you may not be able to obtain and remit U.S. dollars abroad upon the disposition of, or distributions relating to, the preferred shares unless you obtain your own electronic certificate of registration or register your investment in the preferred shares under Resolution No. 2,689 of January 26, 2000 of the National Monetary Council, known as Resolution No. 2,689, which entitles foreign investors to buy and sell securities on the São Paulo Stock Exchange. If you obtain an electronic certificate of registration under Resolution No. 2,689, you may be subject to favorable tax treatment on gains with respect to the preferred shares unless you are resident in a tax haven jurisdiction. See "Taxation—Brazilian Tax Consequences." If you attempt to obtain your own electronic certificate of registration, you may incur expenses or suffer delays in the application process, which could delay your ability to receive dividends or distributions relating to the preferred shares or the return of your 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 you may not be affected by future legislative changes, or that additional restrictions applicable to you, 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 your ability to sell the preferred shares underlying the ADSs at the price and time you desire.

Investing in securities involving emerging market risk, including risks relating to Brazil, involves greater risk than investing in securities of issuers from more developed countries and such investments are generally considered speculative in nature. Investments involving risks relating to Brazil, such as investments in ADSs, are subject to economic and political risks, involving, among others:

- changes in the regulatory, tax, economic and political environment that may affect the ability of investors to receive payment, in whole or in part, in respect of their investments; and

- restrictions on foreign investment and on repatriation of capital invested.

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 your ability to sell the preferred shares underlying the ADSs at the price and time you desire. See "Market Information—Trading on the São Paulo Stock Exchange."

We are subject to different corporate rules and regulations as a Brazilian company, and the ADSs have fewer and less well-defined shareholders' rights.

Our corporate affairs are governed by our bylaws and the Brazilian corporation 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. In addition, your rights or the rights of holders of the preferred shares under the Brazilian corporation law to protect your interests relative to actions by our board of directors may be fewer and less well-defined than under the laws of those other jurisdictions outside Brazil.

Although Brazilian 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.

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, PREVI and 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; you may not be able to sell your securities at or above the price you paid for them.

Sales of a substantial number of preferred shares after the consummation of this offering, or the belief that this may occur, could decrease the trading price of the preferred shares and the ADSs. We currently have 374,803,426 preferred shares outstanding, including 165,081,477 preferred shares held by Cia. Bozano and the selling shareholders after giving effect to this offering and the Brazilian offering. Of this amount, holders of exchangeable notes issued by BNDES (including notes that may be issued pursuant to the exercise of an over-allotment option) will have the right to acquire, at any time prior to the maturity of the notes, an aggregate of 6,373,500 ADSs, representing 25,494,000 preferred shares currently owned by BNDESPAR, subject to adjustment. Bozano Holdings Ltd. has agreed to purchase exchangeable notes in the principal amount of US$34,500,000 from the initial purchasers in the concurrent private offering by BNDES. Embraer, its executive officers and directors, the selling shareholders in the international offering and certain other shareholders have agreed that, subject to exceptions, they will not (1) offer, pledge, sell, contract to sell, sell any option or contract to purchase, purchase any option or contract to sell, grant any option, right or warrant to purchase, lend or otherwise transfer or dispose of, directly or indirectly, any common shares, preferred shares or ADSs, or any securities convertible into or exercisable or exchangeable for such common shares, preferred shares or ADSs, or (2) enter into any swap or other arrangement that transfers to another, in whole or in part, any of the economic consequences of ownership of such common shares, preferred shares or ADSs without the prior written consent of Morgan Stanley & Co. Incorporated for a period of 90 days after the date of this prospectus. This restriction does not apply to any securities acquired in open market transactions after completion of the offering, including the exchangeable notes and the ADSs received upon exchange thereof. In addition, according to our bylaws, subject to the Brazilian corporation law—which provides that no more than two-thirds of the capital stock of a company may be represented by preferred shares—our shareholders may authorize the conversion of common shares into preferred shares, on a voluntary basis, at a conversion rate of one to one at the time of the conversion. Currently, 36,761,823 outstanding common shares could be converted into preferred shares. As a consequence of the issuance of preferred shares, sales by our selling shareholders or other existing shareholders, or the conversion of common shares, the market price of the preferred shares and, by extension, the ADSs may decrease significantly. As a result, you may not be able to sell your securities at or above the price you paid for them. See ''Principal and Selling Shareholders'' and ''Description of Capital Stock.''

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

Our stock option plan could substantially dilute the preferred shares. Under the terms of our stock plan, we are authorized to grant options to purchase up to 25,000,000 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. In case options are exercised, the price of the preferred shares will be equal to the weighted average price of the preferred shares traded on the São Paulo Stock Exchange in the 60 trading days prior to the grant date, increased or decreased by up to 30%, as defined by a committee appointed by our board of directors. Such percentage is deemed to offset unusual fluctuations in the market price. As of the date of this prospectus, options for an aggregate of 19,950,000 preferred shares have been granted. Stock options representing 4,515,000 preferred shares were exercisable beginning in May 2001.

You might be unable to exercise preemptive rights with respect to the preferred shares.

You may not be able to exercise the preemptive rights relating to the preferred shares underlying your 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 you that we will file any such registration statement. Unless we file a registration statement or an exemption from registration applies, you may receive only the net proceeds from the sale of your preemptive rights by the depositary or, if the preemptive rights cannot be sold, they will be allowed to lapse.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus includes forward-looking statements, within the meaning of Section 27A of the Securities Act and Section 21E of the U.S. Securities Exchange Act of 1934, as amended, or the Exchange Act, principally in "Risk Factors," "Management's Discussion and Analysis of Financial Condition and Results of Operations," "Regional Aircraft Industry Overview" and "Business." 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 ERJ 170/190 regional 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;
- existing and future governmental regulation; and
- other risk factors as set forth under "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 prospectus might not occur. Our actual results could differ substantially from those anticipated in our forward-looking statements.

PRESENTATION OF FINANCIAL AND OTHER DATA

All references herein to the ''*real*,'' ''*reais*'' or ''R$'' are to the Brazilian *real*, the official currency of Brazil. All references to ''U.S. dollars,'' ''dollars'' or ''US$'' are to United States dollars. For convenience only, we have translated some of the Brazilian currency amounts contained in this prospectus into U.S. dollars at a rate of R$2.1616 to US$1.00, the commercial selling rate at March 31, 2001 as reported by the Central Bank unless otherwise indicated. The commercial selling rate is used in this prospectus rather than the noon buying rate in New York City as reported by the Federal Reserve Bank of New York because the noon buying rate was not consistently reported for *reais* during the periods shown in this prospectus. As a result of the recent fluctuations in the *real*/dollar exchange rate, the commercial selling rate may not be indicative of current or future exchange rates. Therefore, you should not read these translations as representations that any such amounts have been, could have been or could be converted into U.S. dollars at that or at any other exchange rate. See ''Exchange Rates'' for information regarding exchange rates applicable to the *real* since January 1, 1996.

Our Financial Statements

Our audited financial statements at and for the years ended December 31, 1998, 1999 and 2000 and unaudited interim financial statements at and for the three months ended March 31, 2000 and 2001 are included in this prospectus. The audited financial statements at and for the years ended December 31, 1998, 1999 and 2000 have been audited by Arthur Andersen S/C, and the unaudited interim financial statements at and for the three months ended March 31, 2000 and 2001 have been subject to a limited review by Arthur Andersen S/C, which consists principally of applying analytical procedures to financial data and making inquiries of persons within our company responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. The financial statements included in this prospectus are based upon our financial statements and accounting records prepared in Portuguese and maintained in applicable Brazilian currency and in accordance with generally accepted accounting principles in Brazil, or Brazilian GAAP, determined in accordance with Law No. 6,404, as amended, or the Brazilian corporation law, the rules and regulations issued by *Comissão de Valores Mobiliários*, or the Brazilian Securities Commission, and the technical releases issued by *Instituto Brasileiro de Contadores*, or the Brazilian Institute of Accountants.

Embraer, like other Brazilian public companies, was, until December 31, 1995, required to prepare financial statements using two accounting methods prescribed under the Brazilian corporation law and Brazilian Securities Commission regulations that were designed to adjust financial statements for the effects of inflation: (1) the ''corporate law method'' prescribed by the Brazilian corporation law; and (2) the ''constant currency method,'' which provided for the presentation of price-level adjusted financial statements. The Brazilian corporate law method provided a simplified methodology for addressing the effects of inflation. However, this method did not fully recognize the effects of inflation in balance sheet accounts and in many of the accounts on the statement of income, changes in shareholders' equity and changes in financial position and did not require monetary restatement of financial statements from prior years for comparative purposes. However, such financial statements were, and continue to be, the basis for determining income taxes as well as the amount of cash and of share dividends. Under the constant currency method, all amounts in the financial statements are restated in constant *reais* that have the purchasing power of *reais* at the latest balance sheet date for such financial statements. All transactions and balances are monetarily restated to reflect price level changes, as measured by a prescribed price-index, from the date they occurred or were generated to the latest balance sheet date.

On December 26, 1995, the Brazilian government enacted Law No. 9,249, which terminated mandatory inflation accounting for financial statements at dates and for periods ended after December 31, 1995. After enactment of Law No. 9,249, the Brazilian Securities Commission issued, in March 1996, Instruction No. 248, which provides that Brazilian companies may elect to present financial statements using the constant currency method. Orientation Rule No. 29, issued in April 1996, clarified that any voluntary presentation of financial statements using the constant currency method must follow the Brazilian Securities Commission regulations in existence prior to Law No. 9,249 and may be presented as a note to the financial statements prepared in accordance with the corporate law method. Prior to the enactment of Law No. 9,249, Embraer and other Brazilian companies were required to use the *Unidade Fiscal de Referência*, the Fiscal Unit of Reference, an official inflation index, to adjust their financial statements for the effects of inflation. However, Orientation Rule No. 29 currently authorizes the use of any general price index in the preparation of financial statements under the constant currency method. Major inflation indices that are regularly available and issued in Brazil include the General Market Price Index.

We have determined that we will use the General Market Price Index as the inflation index in the preparation of our financial statements prepared in accordance with the constant currency method at dates and for periods ending after January 1, 1996, and we believe that the General Market Price Index constitutes an appropriate basis for reflecting the effects of inflation in our financial statements in the future. Embraer will not use the Fiscal Unit of Reference in periods commencing on January 1, 1996 and in future periods because, among other things, the inflation index is not now published with sufficient regularity to permit the timely presentation of financial statements and the Fiscal Unit of Reference has, in some periods in the past, not fully reflected levels of inflation in Brazil. Accordingly, our financial statements at and for the years ended December 31, 1998, 1999 and 2000 and at and for the three months ended March 31, 2000 and 2001 have been adjusted for inflation and restated in constant *reais* at March 31, 2001 using the General Market Price Index, all in accordance with Brazilian GAAP.

Because we believe that the effects of inflation during 1998, at the rate of 1.8% based on the General Market Price Index, are not material to the presentation of our financial information, we have assumed an annual inflation rate of 0% for 1998 for purposes of applying the constant currency method. See note 2 to our audited financial statements. We believe that the lack of indexation of our consolidated financial statements during 1998 has no material impact on the comparability of this financial data with financial data for other periods.

Our financial statements were, as noted above, prepared in accordance with Brazilian GAAP, which differs in significant respects from accounting principles generally accepted in the United States, or U.S. GAAP. Note 30 to our audited financial statements provides a description of the principal differences between Brazilian GAAP and U.S. GAAP as they relate to Embraer and a reconciliation to U.S. GAAP, for periods presented in our audited financial statements, of net earnings and total shareholders' equity.

Other Data

Some of the financial data contained in this prospectus 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.

We make statements in this prospectus about our competitive position and market share in, and the market size of, the commercial, regional and defense aircraft markets. We have made these statements on the basis of statistics and other information from third-party sources that we believe are reliable. We derive this third-party information principally from publicly available reports published by the Regional Airline Association, known as the RAA, the FAA and the European Regions Airline Association, known as the ERA. In addition, we make statements in this prospectus concerning growth in the regional jet market based on reports published by Stanford Transportation Group LLC and AvStat Associates Inc. in their ''Commercial Jet and Turboprop Market Forecast, 2001-2010'' and by Speed News, Inc., a source for aviation news and information, in its ''Commercial Aircraft Orders and Deliveries—December 31, 2000'' report published on February 2, 2001. Stanford Transportation Group may from time to time be employed by us to assist in analyzing potential markets and market demand characteristics. The above report, however, is an independent analysis which was not prepared specifically for, nor paid for by, Embraer. Although we have no reason to believe any of the above-described information or reports is inaccurate in any material respect, neither we nor the underwriters have independently verified the competitive position, market share, market size or market growth data provided by third parties or by industry or general publications.

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 accompanied by a down payment, where we have reserved a place on one of our three production lines. Every time we refer to our backlog in this prospectus, we only make reference to firm orders, and not to options. When we refer in this prospectus to the number or value of regional aircraft or the number or value of ERJ 145 aircraft, we exclude EMB 145 AEW&C/RS/MP aircraft, two ERJ 145s and two ERJ 135s which were ordered by the Belgian government, and one ERJ 135 aircraft which we delivered to the Greek government. These aircraft have instead been included in our defense data.

USE OF PROCEEDS

We will not receive any proceeds from the sale of ADSs or preferred shares offered by the selling shareholders in the international and Brazilian offerings.

MARKET INFORMATION

Market Prices of Preferred Shares

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 and the reported average weekly trading volume in 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		Average number of ADSs traded per week
	High	**Low**	*(in thousands)*
2000:			
Third quarter (commencing July 20)	31.63	18.50	2,251
Fourth quarter	39.75	25.75	939
Year end	39.75	18.50	1,501
2001:			
First quarter	41.75	34.50	1,244
Second quarter (through June 11)	45.50	36.00	927
Month ended:			
December 31, 2000	39.75	26.94	966
January 31, 2001	41.75	37.00	1,982
February 28, 2001	41.00	35.08	819
March 31, 2001	40.80	34.50	931
April 30, 2001	44.81	36.00	810
May 31, 2001	45.50	39.50	865
June 30, 2001 (through June 11)	41.70	37.35	875

The table below sets forth, for the periods indicated, the reported high and low closing sale prices in nominal *reais* for preferred shares and the reported average weekly trading volume in 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 table also sets forth prices per ADS assuming that ADSs had been outstanding on all periods before July 2000 and translated into U.S. dollars at the commercial market rate for the sale of U.S. dollars for each of the respective dates of such quotations. See "Exchange Rates" for information with respect to exchange rates applicable during the periods set forth below. The common shares are also listed and traded on the São Paulo Stock Exchange.

	Nominal *reais* per preferred share		**Average number of preferred shares traded per week**
	High	**Low**	*(in thousands)*
1996:			
Year end	1.2110	.3579	356
1997:			
Year end	2.5552	.6971	350
1998:			
Year end	2.2308	1.1508	2,792
1999:			
First quarter	1.7262	1.1508	327
Second quarter	4.1500	1.5000	943
Third quarter	5.9900	3.1000	2,925
Fourth quarter	8.1500	5.3200	1,173
Year end	8.1500	1.1508	1,342
2000:			
First quarter	8.7000	7.2000	820
Second quarter	10.4400	7.4600	1,263
Third quarter	11.1200	9.6400	2,365
Fourth quarter	18.3000	12.3000	1,459
Year end	18.3000	7.2000	1,476
2001:			
First quarter	21.5000	17.8200	1,323
Second quarter (through June 11)	25.4500	19.4000	928
Month ended:			
December 31, 2000	18.3000	13.3000	1,189
January 31, 2001	21.0000	17.8200	2,003
February 28, 2001	20.1300	17.9500	845
March 31, 2001	21.5000	19.2000	1,122
April 30, 2001	24.8000	19.4000	962
May 31, 2001	25.4500	22.0600	867
June 30, 2001 (through June 11)	24.7000	22.4500	644

On June 11, 2001, we had 24,281 holders of preferred shares, both held directly or through ADSs, and 3,509 holders of record of common shares. On June 11, 2001, an aggregate of 122,806,536 of our preferred shares, both held directly or through ADSs, were held by 4,960 record holders in the United States.

On June 12, 2001, the closing sale price for our preferred shares on the São Paulo Stock Exchange was R$23.50, which is equivalent to US$39.32 per ADS. On the same date, the closing sale price for our ADSs on the New York Stock Exchange was US$38.90. The ADSs being offered by this prospectus will be issued under a deposit agreement and Morgan Guaranty Trust Company of New York will serve as depositary under that agreement.

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 Brazilian Securities Commission 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 limits of 10% or 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, which accounted for over 97.2% of Brazil's 2000 share trading volume, had an aggregate market capitalization of approximately US$225.5 billion at December 28, 2000 and an average monthly trading volume of approximately US$334.3 million for 2000. In comparison, the New York Stock Exchange had a market capitalization of approximately US$17.1 trillion at December 29, 2000 and an average monthly trading volume of approximately US$922 billion for 2000. 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. As of June 11, 2001, we accounted for approximately 2.7% 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 and other major exchanges in the world. The 10 largest companies in terms of market capitalization represented approximately 46.2% of the aggregate market capitalization of the São Paulo Stock Exchange at December 28, 2000. At December 28, 2000, the five most actively traded shares represented approximately 39.7% 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. See ''Description of Capital Stock—Regulation of Foreign Investment.''

Regulation of Brazilian Securities Markets

The Brazilian securities markets are regulated by the Brazilian Securities Commission, 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 corporation law, a corporation is either public *(companhia aberta)*, like us, or closely held *(companhia fechada)*. All public companies, including us, are registered with the Brazilian Securities Commission 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 Brazilian Securities Commission, 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 Brazilian Securities Commission or the São Paulo Stock Exchange.

The Brazilian securities law and the Brazilian corporation law 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 the preferred shares and the depositary for the ADSs must obtain 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 depositary'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. See ''Description of Capital Stock—Regulation of Foreign Investment.''

CAPITALIZATION

The following table sets forth our actual total cash and cash equivalents, short-term debt and capitalization at March 31, 2001 in accordance with Brazilian GAAP. All amounts are calculated in accordance with Brazilian GAAP and are unaudited. This table should be read in conjunction with ''Selected Financial and Other Data,'' ''Management's Discussion and Analysis of Financial Condition and Results of Operations'' and our unaudited consolidated financial statements included elsewhere in this prospectus.

	As of March 31, 2001	
	(in millions)	
Cash and cash equivalents	R$2,527.9	US$1,169.5
Short-term debt(1)	734.2	339.7
Long-term debt(2)	173.9	80.4
Total debt	908.1	420.1
Shareholders' equity	1,921.4	888.9
Total capitalization(3)	2,095.3	969.3

(1) Includes current portion of long-term debt. Of this amount of short-term debt, R$370.7 million is secured and R$363.5 million is unsecured.

(2) Excludes current portion of long-term debt. Of this amount of long-term debt, R$95.4 million is secured and R$78.5 million is unsecured.

(3) Long-term debt plus shareholders' equity.

EXCHANGE RATES

There are two principal foreign exchange markets in Brazil:

- the commercial rate exchange market; and
- the floating rate 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 are carried out on the commercial rate exchange market. These transactions include the purchase or sale of preferred shares or the payment of dividends or interest with respect to the preferred shares. Foreign currencies may only be purchased through a Brazilian bank authorized to operate in these markets. In both markets, rates are freely negotiated but may be strongly influenced by Central Bank intervention.

From its introduction on July 1, 1994 through March 1995, the *real* appreciated against the U.S. dollar. In 1995, the Central Bank announced that it would intervene in the market and buy or sell U.S. dollars, establishing a band in which the exchange rate between the *real* and the U.S. dollar could fluctuate. This policy resulted in a gradual devaluation of the *real* relative to the U.S. dollar. On January 13, 1999, the band was set at R$1.20 and R$1.32 per US$1.00. Two days later, on January 15, 1999, due to market pressures, the Central Bank abolished the band system and allowed the *real*/U.S. dollar exchange rate to float freely. As a result, the exchange rate dropped to R$2.1647 per US$1.00 on March 3, 1999. Since then, the *real*/U.S. dollar exchange rate has been established by the interbank market, and has fluctuated considerably. At June 12, 2001, the commercial selling rate was R$2.3906 per US$1.00. The Central Bank has only intervened occasionally to control unstable movements in the foreign exchange rate. At the present time, it is not yet possible to predict whether the Central Bank will continue to let the *real* float freely or if the *real* will remain at its present level. Accordingly, it is not possible to predict what impact the Brazilian government's exchange rate policies may have on us. The Brazilian government could impose a band system in the future or the *real* could devalue substantially. See "Risk Factors—Risks Relating to Brazil—Fluctuations in the value of the *real* against the value of the U.S. dollar 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."

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

	Low	High	Average (1)	Period-end
		(*Reais* per US$1.00)		
Year ended December 31,				
1996	.9725	1.0407	1.0052	1.0394
1997	1.0395	1.1164	1.0787	1.1164
1998	1.1165	1.2087	1.1611	1.2087
1999	1.2078	2.1647	1.8158	1.7890
2000	1.7721	1.9847	1.8295	1.9554
2001 (through June 11)	1.9357	2.3895	2.1263	2.3722
Month ended				
December 31, 2000	1.9524	1.9847	1.9633	1.9554
January 31, 2001	1.9357	1.9753	1.9545	1.9711
February 28, 2001	1.9739	2.0452	2.0019	2.0452
March 31, 2001	2.0208	2.1616	2.0891	2.1616
April 30, 2001	2.1384	2.3011	2.1925	2.1897
May 31, 2001	2.1957	2.3600	2.2972	2.3600
June 30, 2001 (through June 11)	2.3619	2.3895	2.3771	2.3722

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 depositary 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.

SELECTED FINANCIAL AND OTHER 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, 1998, 1999 and 2000 are derived from our financial statements audited by Arthur Andersen S/C, independent public accountants, included elsewhere in this prospectus. The selected financial data at and for the years ended December 31, 1996 and 1997 have been derived from our financial statements audited by Arthur Andersen S/C, independent public accountants.

Our financial statements have been restated using the constant currency method to recognize the effects of changes in the purchasing power of the Brazilian currency due to inflation and expressed in constant *reais* of March 31, 2001 purchasing power, using the General Market Price Index. However, because we believe that the effects of inflation during 1998, at the rate of 1.8% based on the General Market Price Index, are not material to the presentation of our financial information, we have assumed an annual inflation rate of 0% for 1998 for purposes of applying the constant currency method.

The summary financial data at and for the three months ended March 31, 2000 and 2001 have been derived from our unaudited interim financial statements included elsewhere in this prospectus, which, in the opinion of management, reflect all adjustments which are of a normal recurring nature necessary for a fair presentation of the results for such periods. The results of operations for the three months ended March 31, 2001 are not necessarily indicative of the operating results to be expected for the entire year ended December 31, 2001. For convenience only, Brazilian currency amounts for the three months ended March 31, 2001 have been translated into U.S. dollars at a rate of R$2.1616 to US$1.00, the commercial selling rate at March 31, 2001.

The financial data from which the selected financial data presented herein are derived have been prepared in accordance with Brazilian GAAP, which differs in significant respects from U.S. GAAP. You should read this data in conjunction with our audited and unaudited financial statements and the notes thereto included elsewhere in this prospectus, as well as ''Presentation of Financial and Other Data'' and ''Management's Discussion and Analysis of Financial Condition and Results of Operations.''

	At and for the year ended December 31,					At and for the three months ended March 31,		
	1996	1997	1998	1999	2000	2000	2001	2001
	(in thousands, except per share/ADS data)							
Income Statement Data								
Brazilian GAAP								
Net sales	R$608,104	R$1,133,921	R$2,104,569	R$4,059,797	R$5,417,476	R$1,140,113	R$1,538,588	US$ 711,782
Gross profit	96,045	275,895	540,225	1,403,416	1,501,538	292,517	572,189	264,706
Selling and administrative expenses	(103,935)	(142,669)	(240,945)	(359,294)	(522,752)	(105,156)	(153,416)	(70,973)
Income from operations before financial income (expenses)	56,612	73,913	236,894	1,001,438	843,199	158,225	395,308	182,877
Financial income (expenses), net	(145,916)	(110,279)	(107,292)	(458,619)	(84,989)	3,317	(122,307)	(56,582)
Income tax benefit (provision)	(898)	149,992	(15,689)	25,436	(256,594)	(67,712)	(76,113)	(35,211)
Net income (loss)	(89,590)	(12,988)	108,778	509,280	512,665	94,134	191,895	88,775
Net income (loss) per share(1)(2)	(.31)	(.02)	.23	1.05	.94	.20	.35	.16
Net income (loss) per ADS(1)(2)	(1.24)	(.08)	.92	4.20	3.76	.80	1.40	.64
Cash dividend per common share(2)(3)	—	—	.11	.24	.50	.03	.05	.02
Cash dividend per preferred share(2)(3)	—	—	.12	.27	.55	.04	.06	.03
Cash dividend per ADS(2)(3)	—	—	.48	1.08	2.20	.14	.22	.10
Cash dividend per ADS (in U.S. dollars)(4)	—	—	US$ .48	US$ .91	US$ 1.13	US$ .12	US$ .10	US$ .10
Weighted average number of common shares outstanding(2)	96,803	175,350	242,544	242,544	242,544	242,544	242,544	242,544
Weighted average number of preferred shares outstanding(2)	40,090	134,562	238,673	238,673	270,028	242,612	300,865	300,865
U.S. GAAP								
Net sales	R$608,104	R$1,133,921	R$2,104,569	R$4,059,797	R$5,417,476			
Gross profit	115,870	301,599	633,991	964,508	1,681,349			
Selling and administrative expenses	(104,755)	(141,412)	(240,973)	(355,860)	(516,155)			
Income (loss) from operations before income (expenses)	(32,982)	59,094	259,999	502,750	935,036			
Financial income (expenses), net	(137,066)	(128,504)	(62,399)	64,972	(116,919)			
Net income (loss)	(126,094)	98,923	208,199	491,982	539,611			
Net income (loss) per common share—basic(1)(2)(5)	(.92)	.31	.41	.97	1.00			
Net income (loss) per common share—diluted(1)(2)(5)	(.92)	.26	.41	.83	.85			
Net income (loss) per preferred share—basic(1)(2)(5)	(.92)	.34	.45	1.07	1.10			
Net income (loss) per preferred share—diluted(1)(2)(5)	(.92)	.28	.44	.91	.93			
Net income (loss) per ADS—basic(1)(2)(5)	(3.68)	1.36	1.80	4.28	4.40			
Net income (loss) per ADS—diluted(1)(2)(5)	(3.68)	1.12	1.76	3.64	3.72			
Balance Sheet Data:								
Brazilian GAAP								
Cash and cash equivalents	R$ 10,930	R$ 139,873	R$ 420,375	R$ 611,255	R$2,358,602	R$ 723,995	R$2,527,916	US$1,169,465
Total assets	1,828,003	2,147,910	3,022,707	4,320,238	5,534,427	4,219,567	6,217,518	2,876,350
Property, plant and equipment	480,192	464,536	460,810	521,769	673,923	528,029	710,212	328,558
Total debt	636,231	512,350	1,092,213	1,269,233	906,948	1,121,288	908,158	420,132
Total liabilities	1,435,859	1,474,940	2,314,956	3,260,728	3,772,757	3,066,294	4,296,136	1,987,480
Shareholders' equity	392,144	672,970	707,751	1,059,510	1,761,670	1,153,273	1,921,382	888,870

	At and for the year ended December 31,					At and for the three months ended March 31,		
	1996	1997	1998	1999	2000	2000	2001	2001
			(in thousands, except per share/ADS data)					
U.S. GAAP								
Total assets	R$1,103,130	R$1,536,519	R$2,545,706	R$3,968,804	R$5,235,096			
Property, plant and equipment	61,551	104,652	167,442	389,898	548,401			
Total debt	636,231	512,350	1,092,213	1,269,233	906,948			
Total liabilities	1,701,090	1,493,824	2,293,400	3,194,748	3,698,603			
Shareholders' equity (deficit)	(597,960)	42,695	252,306	774,056	1,536,493			
Other Financial Data:								
Brazilian GAAP								
Depreciation and amortization	R$ 81,826	R$ 94,386	R$ 151,900	R$ 185,615	R$ 217,427	R$51,128	R$60,057	US$27,784
Capital expenditures	153,717	114,788	117,369	143,695	328,589	32,000	90,617	41,921
Net cash provided by (used in) operating activities	(151,671)	248,926	26,027	432,066	2,058,731	219,959	408,446	188,955
Net cash provided by (used in) financing activities	314,443	(11,382)	377,029	(99,741)	13,862	(75,277)	(146,474)	(67,762)
Net cash used in investing activities	(158,384)	(108,602)	(122,553)	(141,445)	(325,249)	(31,943)	(92,658)	(42,865)
EBITDA(6)	138,438	168,299	388,794	1,187,053	1,060,626	209,353	455,365	210,661
U.S. GAAP								
Depreciation and amortization	R$ 51,790	R$ 53,295	R$ 56,703	R$ 69,730	R$ 70,007			
Capital expenditures	40,481	56,165	56,123	152,215	229,565			
Net cash provided by (used in) operating activities	(228,731)	199,986	(63,765)	440,586	1,978,358			
Net cash provided by (used in) financing activities	278,269	(21,063)	405,577	(99,741)	1,026			
Net cash used in investing activities	(45,148)	(49,979)	(61,307)	(149,965)	(232,039)			
EBITDA(6)	18,808	112,389	316,702	572,480	1,005,043			

	At and for the year ended December 31,					At and for the three months ended March 31,	
	1996	1997	1998	1999	2000	2000	2001
Other Data:							
Aircraft delivered during period:							
To the Regional Market							
EMB 120 Brasília	17	10	13	7	—	—	—
ERJ 145	4	32	60	80	112	24	28
ERJ 135	—	—	—	16	45	10	14
EMB 110 Bandeirante	1	—	—	—	—	—	—
To the Defense Market							
EMB 120 Brasília	—	—	1	—	—	—	—
ERJ 135	—	—	—	—	1	1	—
EMB 312 Tucano	15	—	6	—	—	—	—
AM-X	3	5	10	3	1	—	—
To the Corporate Market							
Legacy(7)	—	—	—	—	2	—	—
To the General Aviation Market Light aircraft	24	24	26	17	17	2	2
Total delivered	64	71	116	123	178	37	44
Aircraft ordered during period:							
In the Regional Market							
EMB 120 Brasília	3	—	20	—	2	—	—
ERJ 145	51	94	64	125	197	86	1
ERJ 135	—	8	126	6	6	24	—
ERJ 140	—	—	—	—	133	—	6
ERJ 170	—	—	—	40	50	—	—
ERJ 190-200	—	—	—	30	—	—	—
In the Defense Market							
EMB 120 Brasília	—	—	1	—	—	—	—
EMB 145 AEW&C	—	5	—	4	—	—	1
EMB 145 RS	—	3	—	—	—	—	—
EMB 145 MP	—	—	—	—	—	—	2
EMB 312 Tucano	—	6	—	—	—	—	—
ERJ 145	—	—	—	—	2	—	—
ERJ 135	—	—	—	1	2	—	—
In the Corporate Market							
Legacy(7)	—	—	—	—	31	—	1
In the General Aviation Market							
Light aircraft	24	24	26	19	15	—	2
EMB 110 Bandeirante	1	—	—	—	—	—	—
Total firm orders received	79	140	237	225	438	110	13
Aircraft in backlog at the end of period:							
In the Regional Market							
EMB 120 Brasília	10	—	7	—	2	—	2
ERJ 145	65	127	131	176	261	238	234
ERJ 135	—	8	134	124	85	139	71
ERJ 140	—	—	—	—	133	—	139
ERJ 170	—	—	—	40	90	40	90
ERJ 190-200	—	—	—	30	30	30	30
In the Defense Market							
EMB 145 AEW&C	—	5	5	9	9	9	10
EMB 145 RS	—	3	3	3	3	3	3
EMB 145 MP	—	—	—	—	—	—	2
EMB 312 Tucano	—	6	—	—	—	—	—
AM-X	19	14	4	1	—	—	—
ERJ 145	—	—	—	—	2	—	2
ERJ 135	—	—	—	1	2	—	2
In the Corporate Market							
Legacy	—	—	—	—	29	—	30
In the General Aviation Market							
Light aircraft	—	—	—	2	—	—	—
Total backlog (in aircraft)	94	163	284	386	646	459	615
Total backlog (in millions)	US$1,227	US$3,011	US$4,112	US$6,365	US$11,421	US$7,654	US$11,137

(1) Based on total number of common shares and preferred shares outstanding at the end of the period under Brazilian GAAP and on a weighted average number of shares outstanding under U.S. GAAP. See note 30 to our audited financial statements.

(2) 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.

(3) Includes interest on shareholders' equity. Shown in nominal *reais*.

(4) 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.

(5) During the fourth quarter of 1997, we made a change in accounting estimates totaling R$139.3 million to recognize deferred tax assets. Based on our projected taxable income for the three years following the fourth quarter of 1997, the amount of tax loss carryforwards for which realization became profitable increased significantly, due to the increase in expected sales and backlog. The earnings per share and per ADS (basic and diluted) computed on the change in accounting estimates are, as of December 31, 1997, as follows:

Basic earnings per common share	1.05
Basic earnings per preferred share	1.16
Basic earnings per ADS	4.64
Diluted earnings per common share	.90
Diluted earnings per preferred share	.99
Diluted earnings per ADS	3.96

(6) EBITDA means net income (loss) before income tax benefit (provision), net non-operating income (expense), net financial income (expenses), depreciation and amortization and minority interest. EBITDA is a non-U.S. GAAP and a non-Brazilian GAAP measurement that does not represent cash flow for the periods presented and should not be considered as an alternative to net income (loss), as an indicator of our operating performance or as an alternative to cash flows as a source of liquidity. Our EBITDA may not be comparable with EBITDA as defined by other companies. Although EBITDA does not provide a U.S. or Brazilian GAAP measure of operating cash flows, it is commonly used by financial analysts and others in the aerospace industry.

(7) Includes two ERJ 135s for the corporate market.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read this discussion in conjunction with our consolidated financial statements and notes thereto and other financial information included elsewhere in this prospectus. This prospectus 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 "Risk Factors" and the matters set forth in this prospectus generally. In addition, all financial data in this section, unless otherwise stated, were prepared in accordance with Brazilian GAAP. See "Presentation of Financial and Other Data."

Embraer

We are the fourth largest manufacturer of commercial aircraft in the world based on 2000 net sales of commercial aircraft. We primarily focus on manufacturing regional aircraft. We are also the leading supplier of defense aircraft to the Brazilian Air Force based on number of aircraft sold. In addition, we are developing a new line of corporate jets based on our ERJ 135 regional jet.

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. This decision has been appealed and a final decision is pending. 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 is trying to reach an agreement with the labor unions on this matter. This ruling represents a potential total liability for the Brazilian government of approximately US$20 billion, 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.

Changes in Brazilian political and economic conditions that have occurred and may occur in the future will require us to continue assessing the risks associated with our activities and to adjust our business and operating strategy accordingly. In addition, political and economic conditions in other emerging markets have an impact on Brazil and on us. See "Risk Factors—Risks Relating to Brazil—Developments in other emerging market countries may affect the market price of the preferred shares and the ADSs and may make it more difficult or expensive for us to obtain additional debt financing." 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.

After the Russian debt crisis in August 1998, for example, foreign investors withdrew funds from emerging market countries, which affected Brazil in particular due to its growing budget and current account deficits. As a result, Brazil's foreign exchange reserves decreased dramatically, falling from US$67.3 billion at August 31, 1998 to US$42.4 billion at October 31, 1998. In September 1998, in order to defend the *real*, the Brazilian government increased the Central Bank's higher interest rate for temporary liquidity assistance to financial institutions, or the TBAN, from approximately 30% to 50% per annum, temporarily curtailed financial institutions' access to funds at the Central Bank's lower interest rate for such assistance, or the TBC, and reduced the minimum maturity for new foreign currency debt and for the rollover of foreign currency debt. Further, in October 1998, the Brazilian government began to implement a fiscal stabilization program designed to increase tax collection, curb government spending and reduce the fiscal deficit. On November 13, 1998, the IMF approved a standby accord with the Brazilian government totaling US$41.5 billion consisting of contributions made by the IMF and, among others, approximately 20 developed country governments and the World Bank. Acceptance of the IMF loan committed Brazil to implementing a combination of spending cuts and tax increases. Despite the fiscal stabilization program and the IMF accord, market confidence continued to erode. Responding to pressure on the *real*, the Central Bank widened the foreign exchange band on January 13, 1999 and effectively abandoned the "crawling peg" policy adopted in 1995. The Central Bank also increased its interventions in the spot and future currency markets. The pressure on the *real*, though, did not ease, and on January 15, 1999, the Central Bank allowed the *real* to float freely. However, the *real* devalued to a low of R$2.1647 per US$1.00 on March 3, 1999 from R$1.2114 on January 12, 1999.

On March 5, 1999, the Central Bank eliminated the TBC and TBAN rates and began to use the Over/Selic rate, currently the key lending rate of the Central Bank. Because the Central Bank can influence the Over/Selic rate on a daily basis through its participation in auctions, repurchase transactions and reverse purchase transactions, the Over/Selic rate enables the Central Bank to respond more quickly to changes in market conditions. Since March 5, 1999, the *real* has fluctuated considerably against the U.S. dollar and at June 12, 2001 was R$2.3906 per US$1.00. The Central Bank has gradually reduced the Over/Selic rate to 16.7% per annum as of June 11, 2001, compared to 44.9% on March 5, 1999, following the devaluation. We cannot assure you that interest rates will continue to fall, that the *real* will remain stable or that Brazilian companies will have improved access to capital markets.

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 Brazilian inflation as measured by the General Market Price Index and the devaluation of the *real* against the U.S. dollar for the periods shown:

									Three months ended March 31,	
	1993	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2000**	**2001**
Inflation (General Market Price Index)	2,567.5%	1,246.6%	15.2%	9.2%	7.7%	1.8%	20.1%	9.9%	1.8%	1.4%
Devaluation (appreciation) (R$ vs. US$)	2,532.5%	613.4%	14.9%	6.9%	7.4%	8.3%	48.0%	9.3%	(2.3)%	10.5%

Inflation and exchange rate variations have had, and may continue to have, substantial effects on our financial condition and results of operations. We are naturally hedged to a significant extent against a devaluation of the Brazilian currency because approximately 94% of our net sales and approximately 83% of our cost of sales were U.S. dollar-denominated in 2000. In addition, more than 95% of our backlog at March 31, 2001 was U.S. dollar-denominated. Because of the 48.0% devaluation of the *real* during 1999 and the 10.5% devaluation of the *real* for the three months ended March 31, 2001, our results in those periods grew significantly more in *reais* than in U.S. dollars. We believe that the effects of devaluation for each of the years ended December 31, 1998 and 2000, and the appreciation of the *real* in the three months ended March 31, 2000, are not material to our results of operations for those periods.

Our materials expenses, which accounted for 81.5% of our cost of sales in 2000, are primarily U.S. dollar-denominated. Although the devaluation of the *real* impacts these expenses negatively, the effect is offset significantly by our high percentage of U.S. dollar-denominated revenues. Our labor expenses, which accounted for approximately 13.1% of our cost of sales in 2000, are primarily in *reais* and, as a percentage of net sales, tend to decrease as the *real* devalues. This positive effect on our labor expenses is often offset by wage inflation, which tends to follow devaluation.

A second significant effect of inflation and exchange rate variations concerns our monetary assets and liabilities denominated in U.S. dollars. The value of these assets and liabilities increases in *real* terms when the *real* devalues against the U.S. dollar and declines when the *real* appreciates. Changes in the value in *reais* of our U.S. dollar-denominated assets and liabilities, specifically our debt, will impact our net income. An increase in U.S. dollar-denominated net liabilities, for example, will result in an exchange loss on our income statement and reduce amounts available for distribution to our shareholders. The most significant impact of devaluation on our monetary assets and liabilities relates to our debt. Because the majority of our debt is foreign currency-denominated (87.0% in 2000), our total debt increases as the *real* devalues.

Finally, because revenues in our defense business have historically been denominated principally in *reais*, while our costs for this segment have been principally denominated in U.S. dollars, devaluation of the *real* adversely affects 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

Our financial statements have been restated using the constant currency method to recognize the effects of changes in the purchasing power of the *real* due to inflation and expressed in constant *reais* of March 31, 2001 purchasing power using the General Market Price Index. However, because we believe that the effects of inflation during 1998, at the rate of 1.8% based on the General Market Price Index, are not material to the presentation of our financial information, we have assumed an annual inflation rate of 0% for 1998 for purposes of applying the constant currency method.

Operating Data

The following chart sets forth statistical data concerning our deliveries, firm orders and backlog for our aircraft, as well as other significant operating information at the end of the respective periods. Deliveries consist of aircraft which 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 accompanied by a down payment, for which we have reserved a place on one of our production lines. Firm orders include both backlog and deliveries.

	At and for the year ended December 31,			At and for the three months ended March 31,	
	1998	1999	2000	2000	2001
Regional					
Deliveries (cumulative)					
ERJ 145	96	176	288	200	316
ERJ 135	—	16	61	25	75
EMB 120 Brasília	338	345	345	345	345
Firm orders (cumulative)					
ERJ 145	227	352	549	438	550
ERJ 135	134	140	146	164	146
ERJ 140	—	—	133	—	139
EMB 120 Brasília	345	345	347	345	347
ERJ 170	—	40	90	40	90
ERJ 190-200	—	30	30	30	30
Total firm orders (cumulative)	706	907	1,295	1,017	1,302
Total backlog (in millions)	US$3,737	US$6,051	US$10,410	US$7,355	US$9,872
Defense					
Total deliveries (cumulative)	682	685	687	686	687
Total backlog (in millions)	US$ 342	US$ 313	US$ 544	US$ 299	US$769
Corporate					
Deliveries (cumulative)	—	—	2	—	2
Firm orders (cumulative)	—	—	31	—	32
Total backlog (in millions)	—	—	US$ 467	—	US$496
Other Operating Information					
Annualized net sales per employee (in thousands)(1)	R$ 365.4	R$ 541.1	R$ 562.6	R$ 521.4	R$555.0
Number of employees (at period end)	6,737	8,302	10,334	8,928	11,481

(1) Based on net sales for the period divided by the average of the number of employees at the end of each quarter during the period.

At March 31, 2001, we also had options outstanding to purchase 316 ERJ 145 aircraft, 25 ERJ 140 and 61 ERJ 135 aircraft. We expect the ERJ 140 to be certified in the second half of 2001, with the first delivery to occur immediately thereafter. We have firm orders scheduled to deliver 111 ERJ 145 aircraft, 15 ERJ 140 aircraft and 28 ERJ 135 aircraft in the year ending December 31, 2001. See ''Business—Production.'' In addition, as of March 31, 2001, we had 133 options outstanding for the ERJ 170 aircraft and 72 options for the ERJ 190-200 aircraft. We expect to commence delivery of the ERJ 170 in late 2002, the ERJ 190-200 in mid-2004 and the ERJ 190-100 in 2005. Furthermore, at March 31, 2001, we had 31 options outstanding for the Legacy, of which 25 options were to Swift Aviation, the launch customer for our corporate jet. We have firm orders to deliver nine Legacy aircraft in the year ended December 31, 2001.

Revenue

We generate our revenues primarily from the sale of regional aircraft, which currently include our ERJ 135/140/145 regional jet family, as well as our EMB 120 Brasília. We also generate revenues from the sale of defense aircraft, which include the EMB 312 Tucano, a turboprop trainer, the AM-X, a jet fighter and the EMB 145 AEW&C/RS/MP surveillance aircraft, and from the sale of our Legacy corporate jets. Net sales of regional aircraft, which were more than 90% denominated in U.S. dollars, accounted for R$4,814.1 million, or 88.9% of our total net sales, in 2000 and R$1,387.5 million, or 90.2% of our total net sales, for the three months ended March 31, 2001. Sales of defense aircraft accounted for R$184.2 million, or 3.4% of our total net sales, in 2000 and R$44.4 million, or 2.9% of our total net sales, for the three months ended March 31, 2001. Of defense net sales, sales to the Brazilian government accounted for 70.5% in 2000 and 67.6% for the three months ended March 31, 2001. Net sales of corporate aircraft, which are 100% denominated in U.S. dollars, accounted for R$52.9 million, or 1.0% of our total net sales, in 2000, resulting from the delivery of two ERJ 135s to the corporate market, as compared to no corporate jet deliveries for the three months ended March 31, 2001. Finally, we generate revenues 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. Our other related businesses accounted for R$366.3 million, or 6.8% of our total net sales, in 2000 and R$106.7 million, or 6.9% of our total net sales, for the three months ended March 31, 2001.

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. We 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 until we deliver the aircraft.

As a result of a decrease in the amounts available under the ProEx program in 1999, we assisted some of our customers affected by this decrease 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. We will continue to record these deductions for the relevant firm orders and options. These deductions amounted to .5% of our net sales in 1999, 2.4% of our net sales in 2000 and 1.9% of our total net sales for the three months ended March 31, 2001.

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 ERJ 135/140/145 and for each Legacy, US$200,000 for each ERJ 170/190 and US$50,000 for each EMB 120 Brasília. As of March 31, 2001, we recorded customer advances of R$40.3 million related to option payments. The deposits, progress payments and option payments are generally non-refundable. We typically give our customers 18 months prior to the scheduled delivery date of the option aircraft to exercise their options. 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 as discussed above. When the aircraft is delivered, we recognize the customer advance as revenue. If a non-refundable option is not exercised, we recognize the advance as other operating income.

We recognize revenue from the sale of our defense aircraft including the research and development for each specific program, in accordance with the percentage of completion method. Our defense customers continue to provide customer advances, which are converted into revenue as we achieve pre-determined percentages of completion of the project, such as conception, development and design, and engineering, systems integration and customization. These installments are generally not refundable.

Cost of Sales

Our cost of sales 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 and amortization*—In accordance with Brazilian GAAP, we amortize our research and development costs for each aircraft type over the number of aircraft expected to be sold in that category. We base our determination of the expected total number of aircraft to be sold on our estimate of the market demand for the relevant aircraft. At the launch of our aircraft, our determination of market demand reflects our analysis of the potential market size and our estimated participation in that market. During the later stages of the product cycle of an aircraft, our estimate of market demand, to an increasing degree, reflects our backlog, options, ongoing contract negotiations and sales efforts.

  We believe this is a reasonable basis for determining the amortization period. We write off deferred amortization of research and development costs as non-operating expenses to the extent that we determine that market demand has decreased and the remaining deferred research and development costs will not be recoverable based on remaining anticipated sales. We depreciate our property, plant and equipment over their useful lives, ranging from four to 48 years, on a straight line basis.

Operating Expenses and Net Financial Income (Expenses)

Operating expenses consist of administrative expenses, selling expenses, other income (expenses), net, equity in unconsolidated subsidiaries and employee profit sharing. Other income (expenses), net consist primarily of provisions for labor claims, feasibility study costs, production improvement costs, inventory loss and obsolescence and unallocated corporate expenses.

Net financial income (expenses) consists primarily of interest expense, interest income derived from cash equivalents and monetary and exchange variations, net. Monetary and exchange variations, net reflect the effects of inflation and exchange fluctuations on our income statement.

Results of Operations

The information below provides a geographical breakdown of our net sales. The geographic allocation is based on the locale of the operator of the aircraft. See "Business."

Net Sales by Geographic Area

	Year ended December 31,			Three months ended March 31,	
	1998	1999	2000	2000	2001
	(in millions of reais)				
Americas excluding Brazil					
Regional	R$1,219.5	R$2,399.7	R$2,562.9	R$ 463.1	R$ 570.0
Defense	—	6.0	—	—	—
Corporate	—	—	52.9	—	—
Other related businesses	119.7	204.6	190.8	49.4	67.4
	1,339.2	2,610.3	2,806.6	512.5	637.4
Brazil					
Regional	126.1	114.6	—	—	37.6
Defense	195.5	233.6	129.8	33.0	30.0
Other related businesses	48.7	166.7	54.9	7.7	6.9
	370.3	514.9	184.7	40.7	74.5
Europe					
Regional	303.1	852.6	2,141.9	537.8	742.9
Defense	5.2	—	54.4	31.5	14.4
Other related businesses	41.2	71.3	103.3	16.6	31.4
	349.5	923.9	2,299.6	585.9	788.7
Others					
Regional	—	—	109.3	—	37.0
Defense	36.6	—	—	—	—
Other related businesses	9.0	10.7	17.3	1.0	1.0
	45.6	10.7	126.6	1.0	38.0
Total	R$2,104.6	R$4,059.8	R$5,417.5	R$1,140.1	R$1,538.6

The following table presents income statement data by business segment:

Summary Financial Data by Business

	Year ended December 31,			Three months ended March 31,	
	1998	1999	2000	2000	2001
			(in millions of reais)		
Net sales					
Regional	R$ 1,648.7	R$ 3,366.9	R$ 4,814.1	R$ 1,000.9	R$1,387.5
Defense	237.3	239.6	184.2	64.4	44.4
Corporate	—	—	52.9	—	—
Other related businesses	218.6	453.3	366.3	74.8	106.7
	2,104.6	4,059.8	5,417.5	1,140.1	1,538.6
Cost of sales					
Regional	(1,262.9)	(2,255.2)	(3,524.5)	(734.3)	(886.8)
Defense	(167.7)	(211.3)	(183.9)	(55.5)	(29.7)
Corporate	—	—	(36.7)	—	—
Other related businesses	(133.7)	(189.9)	(170.9)	(57.8)	(49.9)
	(1,564.3)	(2,656.4)	(3,916.0)	(847.6)	(966.4)
Gross profit					
Regional	385.8	1,111.7	1,289.6	266.6	500.7
Defense	69.6	28.3	.3	9.0	14.7
Corporate	—	—	16.2	—	—
Other related businesses	84.9	263.4	195.4	16.9	56.8
	540.3	1,403.4	1,501.5	292.5	572.2
Operating expenses					
Regional	(92.9)	(107.5)	(203.2)	(54.0)	(72.3)
Defense	(20.9)	(16.5)	(31.5)	(4.8)	(7.8)
Corporate	—	—	(.3)	—	(.3)
Other related businesses	(112.7)	(122.2)	(134.4)	(13.3)	(41.2)
Corporate expenses	(76.9)	(155.8)	(288.9)	(62.2)	(55.3)
	(303.4)	(402.0)	(658.3)	(134.3)	(176.9)
Income from operations before financial income (expenses)	R$ 236.9	R$ 1,001.4	R$ 843.2	R$ 158.2	R$ 395.3

Regional net sales were approximately 78.3%, 82.9% and 88.9% of total net sales for 1998, 1999 and 2000 and 87.8% and 90.2% of total net sales for the three months ended March 31, 2000 and 2001. Defense net sales were approximately 11.3%, 5.9% and 3.4% of total net sales for 1998, 1999 and 2000 and 5.6% and 2.9% of total net sales for the three months ended March 31, 2000 and 2001. Corporate net sales were approximately 1.0% of total net sales for 2000 and 0% of total net sales for the three months ended March 31, 2001. Finally, net sales from other related businesses were approximately 10.4%, 11.2% and 6.8% of total net sales for 1998, 1999 and 2000 and 6.6% and 6.9% of total net sales for the three months ended March 31, 2000 and 2001.

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,						Three months ended March 31,			
	1998		1999		2000		2000		2001	
	(in millions of reais, except percentages)									
Net sales	R$ 2,104.6	100.0%	R$ 4,059.8	100.0%	R$ 5,417.5	100.0%	R$1,140.1	100.0%	R$1,538.6	100.0%
Cost of sales	(1,564.3)	74.3	(2,656.4)	65.4	(3,916.0)	72.3	(847.6)	74.3	(966.4)	62.8
Material	(1,114.8)	53.0	(2,085.5)	51.4	(3,192.0)	58.9	(692.6)	60.8	(792.3)	51.5
Labor	(211.4)	10.0	(394.3)	9.7	(511.9)	9.4	(112.6)	9.9	(125.7)	8.2
Depreciation and amortization	(151.9)	7.2	(160.4)	3.9	(178.9)	3.3	(40.0)	3.5	(42.3)	2.7
Other	(86.2)	4.1	(16.2)	.4	(33.2)	.6	(2.4)	.2	(6.1)	.4
Gross profit	540.3	25.7	1,403.4	34.6	1,501.5	27.7	292.5	25.7	572.2	37.2
Operating expenses										
Administrative	(70.9)	3.4	(103.1)	2.5	(153.4)	2.8	(33.0)	2.9	(37.5)	2.4
Selling	(170.1)	8.1	(256.2)	6.3	(369.3)	6.8	(72.1)	6.3	(115.9)	7.5
Other expenses, net	(40.4)	1.9	(.2)	—	(55.4)	1.0	(22.8)	2.0	(13.0)	.8
Equity in unconsolidated subsidiary	.2	—	(.3)	—	1.5	—	.1	—	—	—
Employee profit sharing	(22.2)	1.1	(42.2)	1.0	(81.7)	1.5	(6.5)	.6	(10.5)	.7
Income from operations before financial income (expenses)	236.9	11.3	1,001.4	24.7	843.2	15.6	158.2	13.9	395.3	25.7
Financial income (expenses)										
Interest expenses	(97.7)	4.6	(150.0)	3.7	(186.3)	3.4	(49.1)	4.3	(30.5)	2.0
Interest income	61.2	2.9	31.4	.8	104.2	1.9	15.0	1.3	51.6	3.4
Monetary and exchange variations, net	(70.8)	3.4	(340.0)	8.4	(2.9)	.1	37.4	3.3	(143.4)	9.3
Non-operating income (expense), net	(5.1)	.2	(58.9)	1.5	22.5	.4	.3	—	(5.1)	.3
Income tax benefit (provision)	(15.7)	.7	25.4	.6	(256.6)	4.7	(67.7)	5.9	(76.1)	4.9
Minority interest	—	—	—	—	(11.4)	.2	—	—	.1	—
Net income	R$ 108.8	5.2%	R$ 509.3	12.5%	R$ 512.7	9.5%	R$ 94.1	8.3%	R$ 191.9	12.5%

The following table presents unamortized research and development costs by aircraft model at March 31, 2001, along with information on options, firm orders in backlog and aircraft delivered at March 31, 2001:

Research and Development Costs

	At March 31, 2001		
	EMB 120	ERJ 135/140/145(1)	ERJ 170/190
	(in thousands, except number of aircraft)		
Deferred costs	R$311.6	R$693.5	R$107.4
Accumulated amortization	309.6	455.2	—
Net	R$ 2.0	R$238.3	R$107.4
Total number of aircraft projected	352	960	650
Total number of aircraft			
Delivered	350	394	—
Firm orders in backlog	2	478	120
Options with exercise dates in:(2)			
2001	2	103	15
2002	—	84	10
2003	—	70	10
2004	—	101	10
2005 and thereafter	—	75	160
Total outstanding options	2	433	205

(1) Research and development costs for the Legacy and the EMB 145 are amortized as part of the ERJ 135/140/145 regional jet family. As a result, the information in this column includes the Legacy and the EMB 145.

(2) Not audited or subject to review by our accountants.

ERJ 135/140/145

Deliveries of the ERJ 145 and the ERJ 135 began in 1996 and 1999, respectively, and we expect deliveries of the ERJ 140 to begin in the second half of 2001. We expect to sell aircraft in the ERJ 135/140/145 regional jet family for at least ten years from first delivery of each type of aircraft. We are developing a new line of corporate jets, the Legacy, based on our ERJ 135 regional jet. We record the research and development expenditures related to the Legacy together with the expenditures for the ERJ 135/140/145 regional jet family. In December 2000, we delivered two corporate jets. Given the sizable current backlog and the number of years the options will be in effect, we do not believe that any reserve for unamortized costs on this regional jet family will be necessary in the foreseeable future.

ERJ 170/190

We are currently developing the ERJ 170/190 regional jet family. We plan to begin delivering the ERJ 170 in late 2002, the ERJ 190-200 in mid-2004 and the ERJ 190-100 in 2005. Because the ERJ 170/190 regional jet family is still in the development phase, no reserves were necessary as of March 31, 2001.

EMB 120 Brasília

During most of the year in 1999, there were 10 options outstanding on the EMB 120 Brasília, and we were negotiating sales of an additional 70 aircraft. However, during November 1999, the 10 options for the EMB 120 Brasília expired without being exercised. In addition, sales negotiations in 1999 for 30 EMB 120 Brasílias with the Brazilian Air Force and for 40 EMB 120 Brasílias with another potential customer terminated without any sales. Based on these events, in December 1999, we wrote off all except R$2.0 million of the unamortized cost related to this aircraft. We had two firm orders for the EMB 120 Brasílias in our backlog at March 31, 2001.

Three Months Ended March 31, 2000 Compared to Three Months Ended March 31, 2001

Net sales. Net sales increased 35.0% from R$1,140.1 million for the three months ended March 31, 2000 to R$1,538.6 million for the three months ended March 31, 2001. Regional net sales increased 38.6% from R$1,000.9 million for the three months ended March 31, 2000 to R$1,387.5 million for the three months ended March 31, 2001. Defense net sales decreased 31.1% from R$64.4 million for the three months ended March 31, 2000 to R$44.4 million for the three months ended March 31, 2001. In 2000, we entered the corporate jet market, which we account for as a new business segment, and delivered two ERJ 135s for the corporate market in December 2000 as compared to no deliveries for the three months ended March 31, 2001. Net sales from other related businesses increased 42.6% from R$74.8 million for the three months ended March 31, 2000 to R$106.7 million for the three months ended March 31, 2001.

The increase in regional sales is primarily due to the devaluation of the *real* in the three months ended March 31, 2001, as well as an increase in deliveries. We experienced a 16.7% increase in ERJ 145 deliveries, from 24 aircraft for the three months ended March 31, 2000 to 28 aircraft for the three months ended March 31, 2001, and a 40.0% increase in ERJ 135 deliveries, from 10 aircraft for the three months ended March 31, 2000 to 14 aircraft for the three months ended March 31, 2001. Our average unit sales price also increased, contributing to the increase in net sales. The decrease in defense sales is primarily due to entering the final stage of the AM-X program, which yields lower revenue than prior stages, partially offset by revenues related to research and development of the EMB 145 AEW&C/RS and the AL-X.

Cost of sales. Cost of sales increased 14.0% from R$847.6 million for the three months ended March 31, 2000 to R$966.4 million for the three months ended March 31, 2001. The increase in cost of sales primarily resulted from increased deliveries in our regional segment.

Cost of sales as a percentage of net sales decreased from 74.3% for the three months ended March 31, 2000 to 62.8% for the three months ended March 31, 2001. Cost of sales as a percentage of net sales was lower for the three months ended March 31, 2001 due to the devaluation of the *real* from the date of purchase of the U.S. dollar-denominated components of our cost of sales to the date of delivery of the related aircraft and the corresponding recognition of revenue, as well as an increase in our average unit sales price. Our gross profit increased 95.6% from R$292.5 million for the three months ended March 31, 2000 to R$572.2 million for the three months ended March 31, 2001.

Operating expenses. Operating expenses increased 31.7% from R$134.3 million for the three months ended March 31, 2000 to R$176.9 million for the three months ended March 31, 2001. This increase was attributable to a 60.6% increase in selling expenses from R$72.2 million for the three months ended March 31, 2000 to R$115.9 million for the three months ended March 31, 2001, a 13.8% increase in administrative expenses from R$33.0 million for the three months ended March 31, 2000 to R$37.6 million for the three months ended March 31, 2001, and a 62.1% increase in employee profit sharing from R$6.5 million for the three months ended March 31, 2000 to R$10.5 million for the three months ended March 31, 2001, offset by a 43.0% decrease in other expenses, net from R$22.8 million for the three months ended March 31, 2000 to R$13.0 million for the three months ended March 31, 2001.

The increase in selling expenses is directly attributable to the increase in the number of regional aircraft delivered in 2001 and the related warranties, training and promotional spare parts. The increase in administrative expenses is primarily due to the hiring of new administrative personnel in order to support increased production and to expand our global presence. The increase in employee profit sharing directly relates to an increase in amounts distributed to shareholders, which is a component in determining the amount payable as employee profit sharing. The decrease in other expenses, net is primarily due to R$21.1 million in expenses related to feasibility studies for the ERJ 170/190 regional jet family incurred in the three months ended March 31, 2000, as compared to R$8.2 million in the three months ended March 31, 2001.

Operating expenses as a percentage of net sales generally remained the same, at 11.8% for the three months ended March 31, 2000 as compared with 11.5% for the three months ended March 31, 2001.

Net financial income (expenses). Interest expense decreased from R$49.2 million for the three months ended March 31, 2000 to R$30.5 million for the three months ended March 31, 2001, primarily due to a net decrease in debt. Interest income increased from R$15.0 million for the three months ended March 31, 2000 to R$51.6 million for the three months ended March 31, 2001 due to an increase in our average cash and cash equivalent balances.

Our net monetary and exchange variations decreased from a gain of R$37.4 million for the three months ended March 31, 2000 to a loss of R$143.4 million for the three months ended March 31, 2001.

The gains relating to exchange variation decreased from a gain of R$37.4 million for the three months ended March 31, 2000 to a loss of R$137.6 million for the three months ended March 31, 2001, due to the devaluation of the *real* in the three months ended March 31, 2001, as compared to the appreciation of the *real* in the three months ended March 31, 2000. The gains (losses) related to monetary variations decreased from a gain of R$35,000 for the three months ended March 31, 2000 to a loss of R$5.8 million for the three months ended March 31, 2001. This decrease generally resulted from an increase in the difference between the contractual inflation index used to restate our debt instruments and the General Market Price Index used in inflation accounting.

Net non-operating income (expense). Net non-operating income (expense) decreased from income of R$304,000 for the three months ended March 31, 2000 to an expense of R$5.1 million for the three months ended March 31, 2001. The decrease in non-operating income (expense) is due to a valuation reserve in the three months ended March 31, 2001 for permanent losses on investments related to fiscal incentives provided by the Brazilian government as a substitute for taxes payable.

Income tax benefit (provision). Our income tax provision increased from R$67.7 million for the three months ended March 31, 2000 to R$76.1 million for the three months ended March 31, 2001 due to our increase in net income as well as the fact that our remaining tax loss carryforward benefits resulting from net losses prior to 1998 were fully recognized in 2000.

Net income. As a result of the foregoing factors, our net income increased 103.9% from R$94.1 million for the three months ended March 31, 2000 to R$191.9 million for the three months ended March 31, 2001. Net income increased as a percentage of net sales from 8.3% of net sales for the three months ended March 31, 2000 to 12.5% of net sales for the three months ended March 31, 2001.

2000 Compared with 1999

Net sales. Net sales increased 33.4% from R$4,059.8 million in 1999 to R$5,417.5 million in 2000. Regional net sales increased 43.0% from R$3,366.9 million in 1999 to R$4,814.1 million in 2000. Defense net sales decreased 23.1% from R$239.6 million in 1999 to R$184.2 million in 2000. In 2000, we entered the corporate jet market, which we account for as a new business segment, and delivered two ERJ135 aircraft, recognizing R$52.9 million in net sales. Net sales from other related businesses decreased 19.2% from R$453.3 million in 1999 to R$366.3 million in 2000.

The increase in regional sales is primarily due to a 40.0% increase in ERJ 145 deliveries, from 80 aircraft in 1999 to 112 aircraft in 2000, as well as a 181.3% increase in ERJ 135 deliveries, from 16 aircraft in 1999 to 45 aircraft in 2000. This increase was partially offset by a decrease in the 2000 average sales price per unit in *reais* resulting from the volatility in that year of the *real*/U.S. dollar exchange rate. Our average sales price per unit in U.S. dollars, on the other hand, increased 2.2% from 1999 to 2000 despite a higher percentage of ERJ 135s in our product mix. The decrease in defense sales is primarily due to entering the final stage of the AM-X program, which yields lower revenue than prior stages, partially offset by revenues related to research and development of the EMB 145 AEW&C/RS and the AL-X and delivery of one ERJ 135 to the Greek government.

Cost of sales. Cost of sales increased 47.4% from R$2,656.4 million in 1999 to R$3,916.0 million in 2000. The increase in cost of sales primarily resulted from increased deliveries in our regional segment and the beginning of deliveries in our corporate segment. In addition, a significant portion of our materials consumed during 1999, primarily for regional aircraft, were purchased prior to the devaluation. As a result, cost of sales in 1999 were significantly lower than in 2000.

Cost of sales as a percentage of net sales increased from 65.4% in 1999 to 72.3% in 2000. Cost of sales as a percentage of net sales was higher in 2000 because of the effects on our 1999 cost of sales of the devaluation of the *real* in 1999. See "—Effects of Inflation and Currency Exchange Fluctuations." Our gross profit increased 7.0% from R$1,403.4 million in 1999 to R$1,501.5 million in 2000.

Operating expenses. Operating expenses increased 63.8% from R$402.0 million in 1999 to R$658.3 million in 2000. This increase was attributable to a 44.1% increase in selling expenses from R$256.2 million in 1999 to R$369.3 million in 2000, a 48.9% increase in administrative expenses from R$103.1 million in 1999 to R$153.4 million in 2000, a 93.6% increase in employee profit sharing from R$42.2 million in 1999 to R$81.7 million in 2000 and an increase in other expenses, net from R$213,000 in 1999 to R$55.4 million in 2000.

The increase in selling expenses is directly attributable to the increase in the number of regional aircraft delivered in 2000 and the related warranties, training and promotional spare parts. The increase in administrative expenses is primarily due to the hiring of new administrative personnel in order to support increased production and to expand our global presence. The increase in employee profit sharing directly relates to our meeting operational goals and an increase in amounts distributed to shareholders, which is a component in determining the amount payable as employee profit sharing. The increase in other expenses, net is primarily due to an increase of R$12.7 million in expenses related to modifications to our products and production processes and an increase of R$10.6 million in expenses related to feasibility studies for the ERJ 170/190 regional jet family. We also expensed R$6.8 million for the manufacturing of a new prototype of the AL-X for testing and training purposes.

Operating expenses as a percentage of net sales increased from 9.9% in 1999 to 12.2% in 2000, primarily as a result of the increases in employee profit sharing and other expenses, net.

Net financial income (expenses). Interest expense increased from R$150.0 million in 1999 to R$186.3 million in 2000, primarily due to underwriting fees incurred in connection with our global equity offering in 2000 as well as interest accrued on disputed taxes. Interest income increased from R$31.4 million in 1999 to R$104.2 million in 2000 due to an increase in our average cash and cash equivalent balances.

Our net monetary and exchange variations decreased 99.1% from a loss of R$340.0 million in 1999 to a loss of R$2.9 million in 2000.

The gains relating to exchange variation increased from a loss of R$367.6 million in 1999 to a gain of R$37.6 million in 2000, due to the higher rate of devaluation of the *real* in 1999 as compared to 2000. The gain in 2000 resulted from the rate of inflation being higher than the rate of devaluation in that year. The gains (losses) related to monetary variations decreased from a gain of R$27.6 million in 1999 to a loss of R$40.6 million in 2000. This decrease generally resulted from an increase in the difference between the contractual inflation index used to restate our debt instruments and the General Market Price Index used in inflation accounting.

Net non-operating income (expense). Net non-operating income (expense) increased from an expense of R$59.0 million in 1999 to income of R$22.5 million in 2000. The non-operating expense in 1999 was due primarily to a write-off of the remaining research and development costs associated with the EMB 120 Brasília in the amount of R$58.5 million. During 1999, options for the EMB 120 Brasília expired unexercised, and we were not able to finalize new sales of the EMB 120 Brasília. Based on these events, in December 1999, we wrote off all research and development costs related to this aircraft except R$2.0 million of the unamortized cost. The increase in non-operating income (expense) is also due to a gain of R$36.0 million resulting from the sale of shares of our subsidiary ELEB-Embraer Liebherr Equipamentos do Brasil S.A. to Liebherr International AG, partially offset by a valuation reserve of R$14.5 million for permanent losses on investments related to fiscal incentives provided by the Brazilian government as a substitute for taxes payable.

Income tax benefit (provision). Our income tax benefit (provision) decreased from a benefit of R$25.4 million in 1999 to a provision of R$256.6 million in 2000 due to our increase in net income as well as the fact that our tax loss carryforward benefits resulting from net losses prior to 1998 were mostly recognized by December 31, 1999.

Net income. As a result of the foregoing factors, our net income increased .7% from R$509.3 million in 1999 to R$512.7 million in 2000. Net income decreased as a percentage of net sales from 12.5% of net sales in 1999 to 9.5% of net sales in 2000.

1999 Compared with 1998

Net sales. Net sales increased 92.9% from R$2,104.6 million in 1998 to R$4,059.8 million in 1999 primarily as a result of a 104.2% increase in regional net sales from R$1,648.7 million in 1998 to R$3,366.9 million in 1999, an increase of 107.4% in other related businesses from R$218.6 million in 1998 to R$453.3 million in 1999 and a small increase of 1.0% in defense net sales from R$237.3 million in 1998 to R$239.6 million in 1999. The devaluation of the *real* accounted for an increase in net sales of approximately 41.9%, which is equivalent to R$882.2 million.

The increase in regional sales is primarily due to a 33.3% increase in ERJ 145 deliveries from 60 aircraft in 1998 to 80 aircraft in 1999. This increase was complemented by the first ERJ 135 deliveries, from no aircraft in 1998 to 16 aircraft in 1999. This increase was partially offset by a 46.2% decrease in EMB 120 Brasília deliveries from 13 aircraft in 1998 to seven aircraft in 1999. The higher average unit sales prices of the ERJ 145 and the ERJ 135 as compared to the EMB 120 Brasília also contributed to the increase in revenues. The small increase in defense sales is primarily due to completing stages of, and recognizing revenue for, the development of the EMB 145 AEW&C and the EMB 145 RS.

Cost of sales. Cost of sales increased 69.8% (compared to a 92.9% increase in net sales) from R$1,564.3 million in 1998 to R$2,656.4 million in 1999. The devaluation of the *real* accounted for an increase in cost of sales of approximately 33.9%, which is equivalent to R$530.0 million. The remainder of the increase primarily resulted from increased cost of sales in each of our business segments, as explained below.

The increase in regional, defense and other related businesses cost of sales is directly attributable to the increase in net sales. In addition, defense cost of sales increased in comparison to defense net sales as a result of a change in product mix from higher margin aircraft, the AM-X, to lower margin aircraft, the EMB 145 AEW&C and EMB 145 RS. In addition, although our defense sales are primarily *real*-denominated, our cost of sales are primarily U.S. dollar-denominated. The devaluation of the *real*, therefore, adversely affected our gross margin in our defense sales. Cost of sales as a percentage of net sales decreased from 74.3% in 1998 to 65.4% in 1999. The decrease in cost of sales as a percentage of net sales was primarily due to lower *real*-denominated costs related to regional sales as a result of the devaluation of the *real*. Our gross profit increased because 95.8% of our revenues are U.S. dollar-denominated while a portion of our costs, primarily related to labor and amortization, are *real*-denominated. In addition to the positive impact of the devaluation of the *real*, we also increased our gross profit due to increased delivery of regional aircraft with greater profit margins, such as the ERJ 145 and ERJ 135.

Operating expenses. Operating expenses increased 32.5% from R$303.3 million in 1998 to R$402.0 million in 1999. This increase was primarily attributable to a 50.7% increase in selling expenses from R$170.0 million in 1998 to R$256.2 million in 1999 and a 45.3% increase in administrative expense from R$70.9 million in 1998 to R$103.0 million in 1999. The increase was partially offset by a decrease in other income (expense), net from an expense of R$40.2 million in 1998 to an expense of R$.5 million in 1999.

The increase in selling expense is directly attributable to selling activities and marketing efforts related to the ERJ 135/145 and ERJ 170/190 regional jet families and our defense aircraft. This increase is also due to the hiring of new sales staff and the establishment of a new department responsible for market strategy and research. We increased our total backlog by 56.1%, from US$4.1 billion at December 31, 1998 to US$6.4 billion at December 31, 1999. The increase in administrative expenses is primarily due to the hiring of new administrative personnel in order to accommodate the increased production.

The decrease in other income (expense), net is primarily due to the reduction of provisions on net losses on inventories of R$27.1 million in 1998 to zero in 1999 and a gain of R$18.8 million in 1999 related to monetary gains due to an increase in inflation over 1998, which could not be allocated to their corresponding income or expense line items. This decrease was partially offset by an expense of R$20.9 million in 1999 related to the preliminary studies and analyses for the ERJ 170/190 regional jet family.

Operating expenses as a percentage of net sales decreased from 14.4% in 1998 to 9.9% in 1999. The primary reason for this decrease was the result of our efforts to maintain administrative and corporate expenses at levels relative to the increase in production, as well as the decrease in other income (expense), net discussed above.

Net financial income (expenses). Interest expense increased 53.5% from R$97.7 million in 1998 to R$150.0 million in 1999. This increase is related to the increase in our debt, caused in part by the devaluation of the *real*. Interest income decreased 48.7% from R$61.2 million in 1998 to R$31.4 million in 1999. This decrease is primarily due to the decrease in real interest rates.

Our net monetary and exchange loss increased 380.2% from R$70.8 million in 1998 to R$340.0 million in 1999. Of this R$340.0 million in monetary and exchange loss, R$367.6 million represents net exchange loss that resulted from the effect of the devaluation on our U.S. dollar-denominated assets and liabilities.

The loss relating to exchange variation, which increased from R$50.8 million in 1998 to R$367.6 million in 1999, was primarily due to the devaluation of the real against the U.S. dollar in 1999. The increase was also due to our having significantly increased U.S. dollar-denominated net liabilities at December 31, 1999, consisting primarily of increase in loans, customers' advances, suppliers and accounts payable. Net monetary variations increased from a loss of R$20.0 million in 1998 to a gain of R$27.6 million in 1999. The increase resulted from the increase in inflation for inflation accounting purposes, which rose from 1.8% in 1998 to 20.1% in 1999, according to the General Market Price Index, offset by the contractual inflation index used to restate our debt instruments.

Net non-operating income (expense). Net non-operating income (expense) increased from R$5.1 million in 1998 to R$59.0 million in 1999. The increase in net non-operating income (expense) is primarily due to a write-off of the remaining research and development costs associated with the EMB 120 Brasília in the amount of R$58.5 million. During 1999, options for the EMB 120 Brasília expired unexercised, and we were not able to finalize new sales of the EMB 120 Brasília. Based on these events, in December 1999, we wrote off all research and development costs related to this aircraft except R$2.0 million of the unamortized cost.

Income tax benefit (provision). Our income tax benefit (provision) increased from a provision of R$15.7 million in 1998 to a benefit of R$25.4 million in 1999. As of December 31, 1999, we had tax loss carryforwards of approximately R$1.2 billion and R$582.1 million for income and social contribution tax purposes, respectively, available to offset future taxable income, representing potential tax benefits in the amount of R$341.8 million. Before 1998, we had net losses and paid no taxes, other than small amounts associated with revenues earned by our foreign subsidiaries. In 1997, we recognized a tax credit of R$150.2 million for income and social contribution tax credits related to our taxes loss carryforwards for 1998, 1999 and 2000. In 1999, we recognized an additional R$96.1 million related to revised projections for 1999 and 2000, as well as an estimate of available tax credits related to 2001, 2002 and 2003. See note 29 to our audited consolidated financial statements.

Net income. As a result of the foregoing factors, our net income increased 368.2% from R$108.8 million in 1998 to R$509.3 million in 1999. Net income also increased from 5.2% of net sales in 1998 to 12.5% of net sales in 1999.

Research and Development

Research and development of aircraft and aircraft components are the largest part of our capital expenditures under Brazilian GAAP. 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 and studies to determine the latest developments in technology and quality standards. As of March 31, 2001, approximately 13.4% of our employees were engaged in research and development.

We begin to incur research and development expenses at the beginning of the development of an aircraft. We amortize research and development expenses based on our expected number of deliveries over the life of the aircraft series. We amortize the portion of research and development related to an aircraft on delivery of the aircraft.

We invest significantly in the development of new projects. Total capital expenditures for 2000 were R$328.6 million, of which R$64.8 million was spent on research and development for the new ERJ 170/190 regional jet family, R$43.5 million was related to research and development for the ERJ 135/140/145 family and

R$217.0 million went to investments in production assets, including improvements to and expansion of our facilities for the development of the ERJ 170/190 regional jet family. Total capital expenditures for 1999 were R$143.7 million, of which R$36.1 million was related to research and development for the ERJ 135/140/145 family, R$2.7 million went to the new ERJ 170/190 regional jet family and R$104.8 million was spent on investments in production assets. Total capital expenditures related to research and development for 1998 were R$70.9 million. Since beginning development of the ERJ 135/140/145 regional jet family, we have invested R$684.7 million at December 31, 2000 in the development of this family. We estimate that our capital expenditures for 2001 will be approximately US$341 million, consisting of approximately US$133 million for research and development for the ERJ 170/190 regional jet family, US$49 million for research and development for the ERJ 135/140/145 regional jet family, including the Legacy, and approximately US$160 million in production assets including improvements to and expansion of our facilities for the development of the ERJ 170/190 regional jet family. We do not account for spending on defense programs as capital expenditures 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 or defense.

The Brazilian government is an important source of funded research and development. Under long-term credit facilities, BNDES has provided us with R$118.3 million for the research and development of the ERJ 145 as of March 31, 2001, and *Financiadora de Estudos e Projetos*, or FINEP, a Brazilian government financing agency, has provided us with R$24.5 million to fund the research and development of the AL-X. The primary funding source of our capital expenditures for defense programs is advance payments from the Brazilian government. We do not enter into the development of a new defense project until the research and development program expenses have been included in the government's budget.

Under U.S. GAAP, the research and development expenses incurred by Embraer would be 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. Under U.S. GAAP, these costs are expensed in the year in which they are incurred. Additions to fixed assets would relate solely to specialized equipment built by us and required for the project. These cash outflows are treated as additions to property, plant and equipment.

Liquidity and Capital Resources

Our liquidity needs arise principally from research and development, capital expenditures, principal and interest payments on our debt and working capital requirements. During the three months ended March 31, 2001 and the years ended December 31, 1998, 1999 and 2000, we relied on funds provided by operations, capital increases, in particular the net proceeds of our global equity offering of ADSs and preferred shares in 2000, capital contributions from risk-sharing partners, borrowings under our credit arrangements and advance payments from the Brazilian government to meet these needs.

Working Capital and Net Cash Provided by Operating Activities

Our working capital (current assets minus current liabilities) has increased significantly from December 31, 1998 to March 31, 2001. We had a working capital deficit at December 31, 1998 of R$15.4 million, as compared to a working capital surplus of R$257.4 million at December 31, 1999, R$1,470.8 million at December 31, 2000 and R$1,607.6 million at March 31, 2001. These increases in working capital were primarily due to increased production, cash contributions from our risk-sharing partners, net proceeds from our global equity offering in 2000 and payments received from one of our customers following financing delays, each of which resulted in increased cash and cash equivalents.

Our net cash provided by operating activities increased from R$220.0 million in the three months ended March 31, 2000 to R$408.4 million in the three months ended March 31, 2001 due to increases in income from operations before financial income (expenses), an increase in liabilities for payments to suppliers resulting primarily from improved coordination between receipt of supplies and use in production, as well as the devaluation of the *real* in 2001. This increase was offset by increases in inventories due to an increase in finished aircraft not delivered at March 31, 2001, the impact of the devaluation of the *real* in 2001, an increase in production and purchases of components for the ERJ 170/190 regional jet family and an increase in accounts receivable related to some customers experiencing delays in receiving financing.

Our net cash provided by operating activities increased from R$432.1 million in 1999 to R$2,058.7 million in 2000 despite a decrease in our income from operations before financial income (expenses). This increase was primarily due to a substantial decrease in inventories resulting from production efficiencies and fewer undelivered aircraft at the end of the year. In addition, accounts receivable decreased as a result of one of our customers finalizing its financing arrangements after the delays in 1999 described below. Additional factors contributing to this increase were the increases in liabilities for suppliers and customer advances, in each case mostly due to increased production, as well as improved coordination in production. Finally, in 2000, we also accrued liabilities in connection with our agreement to make improvements to some of our aircraft.

Our net cash provided by operating activities increased from R$26.0 million in 1998 to R$432.1 million in 1999, as a result of the increase in our income from operations before financial income (expenses). The increase was offset by increases in inventories and accounts receivable. Inventories increased as a result of increased production and the devaluation of the *real*, and accounts receivable increased as a result of delays in one of our customers obtaining more favorable financing, which led to payment delays and our reclassifying R$453.9 million of accounts receivable from current to long-term in December 1999.

Customer Advances and Risk-Sharing Arrangements

In connection with our commercial aircraft contracts, we receive significant customer advances, up to 15% of the total purchase price over the 18 months prior to delivery and recognition of the related revenue. We do not accrue interest on these amounts. At March 31, 2001, customer advances totaled R$820.1 million, 78.5% of which represented current liabilities. In comparison, customer advances totaled R$742.6 million, R$664.3 million and R$393.3 million at December 31, 2000, 1999 and 1998, 78.3%, 66.2% and 59.9% of which represented current liabilities.

Our risk-sharing partners contribute capital to us to fund the development of the regional aircraft for which they are supplying key components. We received total capital and material from risk-sharing partners of R$70.2 million to fund the research and development costs of the ERJ 135/140/145 regional jet family. We also derived liquidity from the deferred payment provisions in certain of our supply contracts, primarily those with our risk-sharing partners. These provisions generally permit us to defer payment of materials for a period of time which typically follows delivery of the related aircraft. At March 31, 2001, the deferred payments to suppliers totaled R$946.9 million, as compared to R$528.6 million, R$399.5 million and R$339.5 million as of December 31, 2000, 1999 and 1998.

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

Our net cash used in financing activities increased from R$75.3 million for the three months ended March 31, 2000 to R$146.5 million for the three months ended March 31, 2001. The increase was due primarily to a net decrease in debt.

Our net cash provided by (used in) financing activities increased from net cash used in financing activities amounting to R$99.7 million in 1999 to net cash provided by financing activities amounting to R$13.9 million in 2000. The increase was due primarily to net cash proceeds from our global equity offering in 2000 and cash contributions received from risk-sharing partners for the ERJ 170/190 regional jet family, offset by a net decrease in debt, primarily short-term debt, the issuance of debentures in 1999 and an increase in dividends paid. Our net cash provided by financing activities decreased from net cash provided by financing activities of R$377.0 million in 1998 to net cash used in financing activities of R$99.7 million in 1999. The decrease was due primarily to a net decrease in debt, primarily short-term debt, an increase in guarantee deposits related to our guarantees of a portion of the financing for one of our customers and an increase in dividends paid. The decrease was offset in part by the issuance of debentures in 1999.

At March 31, 2001, we had total debt of R$908.1 million under our financing arrangements described below, 80.8% of which consisted of short-term debt with average interest rates of 12.8% for *real*-denominated debt and 6.8% for foreign currency-denominated debt. At that date, 12.4% of our total debt consisted of *real*-denominated long-term debt with average interest rates of 12.8%. In comparison, we had total debt of R$906.9 million at December 31, 2000, R$1,269.2 million at December 31, 1999 and R$1,092.2 million at December 31, 1998, consisting of 80.2%, 87.3% and 81.6% of short-term debt. Our total debt decreased in 2001 and 2000 largely due to debt repayment and lower levels of borrowing. Total debt increased in 1999 due to the incurrence of new debt to fund our increased production and sales combined with the effects of the devaluation of the *real* in 1999.

Credit Facilities and Lines of Credit

We maintain credit facilities with BNDES to fund general capital expenditures associated principally with the research and development of the ERJ 145, of which R$118.3 million principal amount was outstanding at March 31, 2001. Amounts borrowed from BNDES are secured by certain equipment, machinery and four ERJ 145 aircraft. The interest rate on amounts borrowed from BNDES range from TJLP plus 3% to TJLP plus 5.5% per annum. We also pay fees to BNDES at the rate of .35% of the sales price of each ERJ 145 that we sell, limited to 420 aircraft sold between January 1, 1997 and December 31, 2005. In addition, we maintain a credit facility with FINEP to fund a portion of our development cost of the AL-X, of which R$24.5 million principal amount was outstanding at March 31, 2001 at an annual interest rate of TJLP plus 4.0%.

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. Amounts advanced under these exchange contracts reflect negotiated discounts from the U.S. dollar payments we are entitled to receive upon delivery of our aircraft. At March 31, 2001, we had R$285.6 million of outstanding debt under these exchange contracts.

In addition, we also have 360-day revolving lines of credit in the aggregate principal amount of US$100.0 million, primarily with Santander Central Hispanoamericano, S.A. and PROBANCA, Servicios Financieros, S.A., to finance the purchase of imported materials. At March 31, 2001, we had borrowed US$99.3 million under these lines of credit. The interest rate on the outstanding amount under these revolving lines of credit is 12-month LIBOR plus .85% per annum. Our line of credit with Santander Central Hispanoamericano, S.A. and PROBANCA, Servicios Financieros, S.A. limits our ability to pay dividends to 50% of our net income and contains covenants requiring us to maintain certain financial ratios. We believe these restrictions will not limit our ability to declare dividends on our capital stock in the future. We also have a 360-day revolving line of credit in the principal amount of the Japanese yen equivalent to US$20 million (or ¥2.3 billion) with The Industrial Bank of Japan, Ltd., New York branch, to finance the purchase of imported materials. At March 31, 2001, we had borrowed ¥2.2 billion under this line of credit. The interest rate on the outstanding amount under this revolving line of credit is 1.9% per annum. This line of credit includes covenants that require a minimum ratio of consolidated EBITDA to consolidated current portion of long-term debt and interest expense of 2.25 to 1 and that limit our ability to grant liens on our assets. We also entered into capitalized leases in 2000 with IBM Brasil Leasing Arrendamento Mercantil S.A. and Debis Financial Services, Inc. relating to the lease of computers and other equipment. At March 31, 2001, R$24.4 million was outstanding under these leases.

We maintain lines of credit from time to time to finance working capital requirements, primarily with Banco do Brasil S.A., Banque Safra-Luxembourg, société anonyme, Credit Mutuel Banque de l'Économie—Crédit Mutuel and NationsBank, N.A., a portion of which is secured by certain equipment and machinery located in our São José dos Campos facility and certain receivables and inventory. At March 31, 2001, we had R$187.2 million aggregate principal amount of outstanding debt under these lines of credit.

We also have guaranteed the minimum residual value of some of our aircraft that have already been delivered. These guarantees run in favor of some of our customers or providers of financing to our customers. These minimum residual values do not exceed our current estimates of the market value of the relevant aircraft types in future years (based on current third-party appraisals of the same type of aircraft). Our guarantees typically ensure that in the 15th year after the year of delivery, the relevant aircraft will have a minimum residual value of 18% to 25% of the original sale price. We may be obligated to make substantial payments in the event that actual residual values of the relevant aircraft decline below the guaranteed levels. We may also be called upon to guarantee the minimum residual value of other aircraft that have not yet been delivered.

Net Cash Used in Investing Activities

Our net cash used in investing activities increased from R$31.9 million in the three months ended March 31, 2000 to R$92.7 million in the three months ended March 31, 2001. Our net cash used in investing activities increased from R$141.4 million in 1999 to R$325.2 million in 2000. Our net cash used in investing activities increased from R$122.6 million in 1998 to R$141.4 million in 1999. In each case, the increase was due primarily to expansion of our production facilities and increased research and development costs for the ERJ 170/190 regional jet family, partially offset by a decrease in research and development costs resulting from our completion of development of the ERJ 135 in 1999.

Capital Contributions and Issuances of Capital Stock

Since January 1998, we have received capital contributions in the aggregate amount of R$491.3 million, representing the issuance of both common and preferred shares. On July 26, 2000, we completed our global equity offering, in which we sold 11,880,000 ADSs, each representing four preferred shares, in an international offering, and 5,280,000 additional preferred shares in a Brazilian offering. The offering price for the international offering was US$18.50 per ADS. The offering price for the Brazilian offering was R$8.45 per preferred share, which was the approximate *real* equivalent of the offering price per ADS in the international offering, adjusted to reflect the ratio of four preferred shares to one ADS. The net proceeds to us from the international and the Brazilian offerings, after deducting underwriting discount and commissions and expenses payable by us were R$456.2 million.

In February and March 1999, we issued 83,330 debentures, with a total historical principal amount of approximately R$150.0 million, that were purchased primarily by BNDESPAR. Each debenture was coupled with 100 detachable subscription warrants. Each subscription warrant entitled its holder to purchase 10 preferred shares or, in limited circumstances, 10 common shares. In February 2000, 833,500 subscription warrants were exercised, representing an issuance of 8,335,000 preferred shares at an issue price of R$2.4228 each. After that date, BNDESPAR became the only holder of subscription warrants. In July 2000, an additional amount of subscription warrants were exercised by BNDESPAR, representing an issuance of 1,057,000 preferred shares at an issue price of R$2.4928 each. 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, which was paid by surrendering all debentures held by BNDESPAR. On May 11, 1999, we redeemed all of our 3,275,365 outstanding class B preferred shares, paying holders of R$15.3 million principal, plus interest and premium of R$9.2 million, totaling R$24.5 million.

Capital Expenditures

We recorded capital expenditures, including research and development costs, of R$117.4 million in 1998, R$143.7 million in 1999, R$328.6 million in 2000 and R$90.6 million for the three months ended March 31, 2001. Research and development costs as a percentage of our capital expenditures were 60.4% in 1998, 27.0% in 1999, 34.0% in 2000 and 52.1% for the three months ended March 31, 2001. The increases in research and development costs as a percentage of our capital expenditures in 2000 and 2001 reflect costs related to the development of the ERJ 170/190 regional jet family. The decrease in research and development costs in 1999 reflects the completion of the research and development phase of the ERJ 135/140/145 regional jet family. Our investments in property, plant and equipment totaled R$46.4 million in 1998, R$104.8 million in 1999, R$217.0 million in 2000 and R$43.4 million for the three months ended March 31, 2001. The increases in 1999, 2000 and 2001 reflect 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 increase as a result of continued construction of new facilities, modifications and improvements to our production facilities and increased research and development costs, each principally related to the ERJ 170/190 regional jet family. We expect capital expenditures to total approximately US$341.3 million in 2001, of which approximately US$132.6 million will be related to the development of the ERJ 170/190 regional jet family and approximately US$159.8 million will be primarily related to improvements to and expansion of our facilities, in particular for the production of the ERJ 170/190 regional jet family, as well as our defense aircraft and corporate jets. For further information regarding these facilities, see "Business—Production" and "Business—Properties." The increase in research and development costs should be offset to some extent by increased participation of risk-sharing partners in the development of our aircraft. We estimate that the total amount necessary to develop the ERJ 170/190 regional jet family will be approximately US$858 million. Of that amount, our capital expenditures will be approximately US$568 million. To cover part of our capital expenditures, our risk-sharing partners will contribute to us a total of US$256 million in cash, of which we have received US$145.8 million as of March 31, 2001.

We believe that the funds provided by operations, the net proceeds from our global equity offering in 2000, cash contributions from risk-sharing partners, customer advances, deferred payments to suppliers and the funds provided by the credit facilities and lines of credit described above will be sufficient to develop the ERJ 170/190 regional jet family, make other planned capital expenditures and fund our future liquidity needs. The risk-sharing partners' cash contributions are refundable under certain limited circumstances, including when we are unable to obtain certification of the aircraft from the applicable regulatory authorities. Our rights to the cash contributions also depend on satisfactory completion of a number of steps in our production process. We may need to find other sources of capital. We cannot assure you that these other funds will be available to us on acceptable terms or at all. If we are unable to secure necessary additional capital, we will not be able to develop and market our ERJ 170/190 regional jet family.

Quantitative and Qualitative Disclosure About Market Risk

We are exposed to various market risks, primarily related to potential loss arising from adverse changes in interest rates and foreign currency exchange rates. We generally do not have derivative financial instruments to hedge these risks, other than those specified below. However, we may carry derivative financial instruments in the future solely to hedge our interest rate or foreign exchange market risk and not for speculative purposes. The following sections address the significant market risks associated with our financial activities.

Interest Rate Risk

Our exposure to market risk for interest rate fluctuations arises from our variable rate short-term and long-term debt obligations, as well as our short-term investments. Our interest rate exposure principally relates to changes in the market interest rates of our U.S. dollar-denominated and *real*-denominated assets and liabilities. Increases and decreases in prevailing interest rates generally translate into increases and decreases in interest payments on debt and interest income on monetary assets. Additionally, fair values of interest rate-sensitive instruments may be affected by general market conditions.

Assets. We primarily invest in short-term financial assets with low risk, such as bank certificates of deposit and money market funds, denominated in *reais*, which generally earn interest based on the Brazilian overnight interest rate for interbank deposits, referred to as the CDI. At March 31, 2001, our short-term investments totaled R$2,490.7 million. Our investments in interest rate-sensitive instruments are not made for trading purposes. Our certificates of deposit and financial investment funds guarantee a minimum rate of return, usually 101% of the CDI. The CDI ranged from 15.2% per annum to 19.4% per annum during 2000 and was 14.2% per annum at March 31, 2001.

Liabilities. Our foreign currency-denominated debt at March 31, 2001 was primarily U.S. dollar-denominated and bore interest at a variable rate based on six-month or 12-month LIBOR. All of our *real*-denominated debt at March 31, 2001 bore interest at a variable rate based on the TJLP, the long-term interest rate in Brazil. The TJLP ranged from 9.8% per annum to 12.0% per annum in 2000 and was 9.25% per annum at March 31, 2001. Our financing costs, therefore, are subject to changes in these indices. At March 31, 2001, we had R$795.4 million of foreign currency-denominated debt and R$112.8 million of *real*-denominated debt.

As of March 31, 2001, we did not have any hedging instruments related to our floating rate, foreign currency-denominated debt, which is indexed to LIBOR. We believe our potential risk for debt indexed to LIBOR is not material because these rates have historically been lower and more stable than interest rates in Brazil.

We do not currently have any derivative instruments which limit our exposure to changes in the TJLP, because we believe that our short-term CDI investments provide a natural hedge to this market risk. However, the CDI generally tends to be more volatile than the TJLP. We may lose this hedge, at least in part, if the CDI decreases significantly and the TJLP does not decrease to the same extent, in which case our interest payments will not be offset by the return on our short-term financial investments.

The table below provides information about our short-term and long-term debt obligations as of March 31, 2001 that are sensitive to changes in interest rates and foreign currency exchange rates.

	Weighted Average interest rate 2001	Total principal amount	Principal by year of maturity 2001	2002	2003	2004	2005	Thereafter	Total
			(in thousands, except percentages)						
Short-term debt									
U.S. dollars (LIBOR indexed)	7.5%	228,898	148,715	80,183	—	—	—	—	228,898
U.S. dollars (fixed rate)	6.5%	365,784	298,489	67,295	—	—	—	—	365,784
Reais (TJLP indexed)	13.0%	25,797	19,475	6,322	—	—	—	—	25,797
French francs (LIBOR indexed)	7.4%	113,520	113,520	—	—	—	—	—	113,520
Japanese yen	1.9%	213	213	—	—	—	—	—	213
Total short-term debt		734,212	580,412	153,800	—	—	—	—	734,212
Long-term debt									
U.S. dollars (LIBOR indexed)	9.6%	30,970	—	6,482	8,643	8,643	7,202	—	30,970
U.S. dollars (fixed rate)	10.2%	18,288	—	3,636	4,817	4,687	5,147	—	18,287
Reais (TJLP indexed)	13.5%	86,976	—	19,714	26,278	23,951	15,912	1,122	86,977
Japanese yen	1.9%	37,712	—	37,712	—	—	—	—	37,712
Total long-term debt		173,946	—	67,544	39,738	37,281	28,261	1,122	173,946
Total debt		908,158	580,412	221,344	39,738	37,281	28,261	1,122	908,158

Foreign Currency Risk

Approximately 70.9% of our debt was U.S. dollar-denominated at March 31, 2001. Our exposure to variations in the U.S. dollar/*real* exchange rate is naturally hedged because approximately 94% of our net sales and approximately 84% of our cost of sales in 2000 were U.S. dollar-denominated. In addition, more than 95% of our backlog at March 31, 2001 was U.S. dollar-denominated. Due to this natural hedge, we generally do not currently hedge our foreign currency liabilities with derivative instruments. As of March 31, 2001, we had a derivative instrument in the notional amount of US$13.1 million solely to hedge the currency risk of a purchase contract relating to five firm orders for the ERJ 135/140/145 regional jet family, which includes an option for the purchaser to pay us in euro. Through December 31, 2000, gains in these derivatives were deferred until the delivery of the related aircraft under both Brazilian and U.S. GAAP. At January 1, 2001, we adopted SFAS 133 and, as a result, we recognized a gain of R$1.2 million for the three months ended March 31, 2001 related to this derivative instrument. See "—Recent Accounting Pronouncements" for further discussion of SFAS 133.

We also had a derivative instrument in the notional amount of US$22.1 million to hedge, with reference to the U.S. dollar, all currency risk of our debt denominated in Japanese yen. These derivative instruments are recorded at their spot market value on our balance sheet, with unrealized losses recorded under monetary and exchange variations, net, on our income statement. Additionally, as of March 31, 2001 we had derivative instruments in the notional amount of US$46.2 million to partially hedge the currency risk of accounts receivable denominated in U.S. dollars. These derivatives are recorded at their spot market value on our balance sheet with unrealized losses recorded under net monetary and exchange variation on our income statements under SFAS 133. We recorded unrealized losses on these derivative instruments in the amount of R$4.9 million for the three months ended March 31, 2001. Our exposure to currency fluctuations amounted to R$1.6 billion at March 31, 2001, the *real* equivalent of our foreign currency-denominated net liabilities at that time.

U.S. GAAP Reconciliation

Our net income under Brazilian GAAP was R$512.7 million in 2000, R$509.3 million in 1999 and R$108.8 million in 1998. Under U.S. GAAP, we would have reported net income of R$539.6 million in 2000, R$492.0 million in 1999 and R$208.2 million in 1998.

Our consolidated financial data recognize the effects of inflation as permitted under Brazilian GAAP. The reconciliation to U.S. GAAP of our net income, as well as of total shareholders' equity, does not reverse the effects of such inflation accounting. See ''Presentation of Financial and Other Data.''

The principal differences other than inflation accounting for 2000, 1999 and 1998 between Brazilian GAAP and U.S. GAAP that affect our net income, as well as shareholders' equity, relate to the treatment of the following items:

- Cash contributions for investment in new programs from suppliers are recorded as equity under Brazilian GAAP and, if contributions are unconditional, as income under U.S. GAAP;
- Under U.S. GAAP, conditional cash contributions for investment in new programs from suppliers are recognized as a reduction of cost of sales at the time the conditions are satisfied;
- Under Brazilian GAAP, fixed assets may be revalued and the net increase (less taxes) credited to shareholders' equity. Under U.S. GAAP, such revaluation is not permitted. Therefore, under U.S. GAAP, these amounts would be subtracted from equity, and depreciation expense under U.S. GAAP would decrease;
- Under Brazilian GAAP, research and development costs may be deferred, but under U.S. GAAP, they must be expensed;
- The amount of interest costs incurred as part of production that may be capitalized differs under Brazilian and U.S. GAAP;
- Under Brazilian GAAP, no compensation expense is recognized for stock options granted;
- Under U.S. GAAP, investments in specialized equipment, or tooling costs, are considered to be fixed assets rather than deferred charges;
- The warrants which were issued by us coupled with the debentures that we sold in February and March of 1999 are dilutive under U.S. GAAP; and
- Under Brazilian GAAP, expenses of equity offerings may be charged to the income statement. Under U.S. GAAP, these expenses are deducted from the total proceeds of the offering and the net amount is recorded in shareholders' equity.

See note 30 to our audited consolidated financial statements for a description of these differences as they relate to us and a reconciliation to U.S. GAAP of net income and total shareholders' equity.

Recent Accounting Pronouncements

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, ''Accounting for Derivative Instruments and Hedging Activities,'' known as SFAS 133. SFAS 133, as amended, is effective for fiscal years beginning January 1, 2001. SFAS 133 requires that all derivative instruments be recorded on the balance sheet at fair value. Changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income, depending on whether a derivative is designated as part of a hedge transaction and the type of hedge transaction. We currently record some of our derivative instruments at the spot market value on our balance sheet and charge to income unrealized gains and losses. Other derivatives are related to purchase contracts for firm orders in currencies other than the U.S. dollar, our functional currency, and accordingly, gains and losses are recognized only upon delivery of the related aircraft. As a result of the adoption of SFAS 133 at January 1, 2001, we recognized a loss of R$2.2 million related to these derivatives for the three months ended March 31, 2001. We expect that the adoption of SFAS 133 will result in non-cash adjustments to income and shareholders' equity. We cannot estimate the amounts of any such adjustments since they will depend on future changes in interest and exchange rates.

In December 1999, the Commission issued Staff Accounting Bulletin No. 101, ''Views on Selected Revenue Recognition Issues,'' known as SAB 101, which became effective on September 1, 2000. SAB 101 sets forth the Commission's views in applying generally accepted accounting principles to selected revenue recognition issues. The adoption of SAB 101 had no impact on our financial statements.

In March 2000, the Financial Accounting Standards Board issued FASB Interpretation No. 44, ''Accounting for Certain Transactions Involving Stock Compensation,'' known as FIN 44. FIN 44 became effective July 1, 2000. FIN 44 clarifies the application of APB Opinion No. 25, ''Accounting for Stock Issued to Employees,'' for certain issues. The adoption of this standard had no impact on our financial statements.

On March 22, 2001, the *Conselho Federal de Contabilidade,* or the Federal Accounting Council, issued technical pronouncement CFC No. 900, known as CFC 900, changing Brazilian generally accepted accounting principles. CFC 900 requires the preparation of financial statements under the constant currency method only when cumulative inflation rates, computed based on the General Market Price Index, approximate or exceed 100% over a three-year period. We have decided to continue preparing our financial statements under the constant currency method until the Brazilian Institute of Accountants and the Federal Accounting Council determine guidelines for the transition and comparability of financial statements prepared under the constant currency and corporate law methods.

REGIONAL AIRCRAFT INDUSTRY OVERVIEW

Industry Background

The market for regional aircraft is driven primarily by the growth of passenger air travel with regional airlines, which generally specialize in routes shorter than 1,000 kilometers (540 nautical miles) with an average travel time of approximately one hour. In the past, regional airlines primarily operated turboprop aircraft, providing air service to cities and towns not served by large carriers as well as off-peak services on routes served by large jets.

In the mid-1980s, a group of new turboprop aircraft were introduced that were larger and faster than the first generation of turboprops, enabling regional airlines to expand services. When major airlines reorganized their operations following deregulation in the United States, many regional routes that were unprofitable for their larger aircraft due to higher operating costs were taken over by smaller regional airlines. The regional airlines benefited from the better economics inherent in smaller, lower priced aircraft with lower seating capacity and lower operational costs, such as reduced weight, fuel consumption, personnel costs and airport fees. In the early 1990s, the Gulf Crisis and an economic downturn caused major airlines to suffer significant losses and a number of major airlines established affiliated regional operators for their remaining regional routes. A similar reorganization of operations occurred in Europe, following the beginning of deregulation in 1985.

Regional Airlines Growth

Regional airlines have experienced significant growth over the past decade, primarily in the United States and Europe. According to the FAA, from 1995 to 2000, regional airlines in the United States have experienced average annual growth in revenue passenger miles of 13.4%, compared to 5.1% growth for major airlines. Over the same period, the number of passengers flown by regional airlines increased an average 7.4% per year, compared to 4.0% growth for major airlines. According to the RAA and AvStat Associates, third quarter 2000 results for U.S. regional airlines compared to third quarter 1999 saw an increase of approximately 22% in revenue passenger miles, with 22.3 million passengers flown, representing an 8.2% increase. According to the ERA, passenger kilometers in Europe have increased at a compound annual growth rate of approximately 17% from 1994 to 1999.

According to a report by Stanford Transportation Group LLC and AvStat Associates, published on February 27, 2001 in *Commuter/Regional Airline News*, which we refer to as the Stanford/AvStat Report, a total of 853 regional turboprop and 3,787 regional jet deliveries in the 20-110 seat regional airline fleet are expected worldwide between 2001 and 2010. The FAA forecasts U.S. revenue passenger miles to grow at an average annual rate of 7.3% over the 12-year period ending 2012, up from 22.3 billion in 2000 to 52.1 billion in 2012, and the number of passengers flown to grow by an average annual rate of 5.6% during the 12-year period ending 2012, reaching a total of 153.7 million passengers in 2012.

To meet this growing demand, regional airlines will have to increase capacity. Due to present constraints in the existing air transportation infrastructure to accommodate increased frequencies on some routes caused by congested airports and airways, regional airlines will need larger and faster aircraft to meet the increasing demand. As a result, the Stanford/AvStat Report forecasts that size categories that accommodate between 60 and 110 passengers will constitute the largest percentage of aircraft deliveries between 2001 and 2010.

Regional Jet Demand Drivers

We believe that substantial worldwide growth in the regional airline market over the next decade, especially in the United States and Europe, combined with a strong passenger preference for jet aircraft service on regional flights and greater nautical mile range for regional aircraft, will significantly increase regional airlines' demand for low-cost, high-performance regional jet aircraft. The number of turboprop deliveries has dropped sharply since deliveries of regional jets began in the mid-1990s. At the same time, deliveries of regional jets have risen sharply. According to the Stanford/AvStat Report, jet-powered aircraft constituted 68% of regional aircraft delivered in 1999. Jet-powered aircraft are forecasted to account for 82% of regional aircraft deliveries between 2001 and 2010. We believe that this increased demand for regional jets is being driven by several factors, including:

- *Aircraft acquisition cost and replacement of larger, less efficient jets.* Regional jets have lower acquisition, personnel and maintenance costs and lower airport fees than larger jets. As a result, routes with low passenger traffic are best served by more cost-effective regional airlines than by major airlines using larger aircraft. In addition, regional jets permit regional airlines to offer direct services on new, short point-to-point routes that are too small for larger jets. Regional jets also enable airlines to increase frequencies on routes regularly served by larger jets, thereby allowing regional airlines to better complement their major airline partners' schedules with off-peak service.

- *Longer reach and deeper market penetration.* The greater range and speed of a jet compared to a turboprop enables airlines to draw more passengers into a given hub, lengthening the ''spokes'' or the cities and towns that are served by each hub. Longer spokes and the increased frequency of services traditionally offered by turboprop aircraft allow regional jets to add additional groups of connecting flights, and fly to and from additional markets which are farther from the hub. According to the Stanford/AvStat Report, the average new route length for regional aircraft increased from 271 miles between 1990 and 1995 to more than 444 miles between 1995 and 2000, an increase of nearly 64%.

- *Growth through hub bypassing.* Regional jets are also being used to bypass major hubs altogether. We believe that long-term hub bypassing strategies of regional airlines could potentially reduce the need for larger, more expensive aircraft types in these markets.

- *Passenger preference for jets over turboprops.* Customers worldwide strongly prefer jet-powered aircraft over turboprops. This preference for jets is due to the greater speed, range and versatility of jets. In addition, jet aircraft are quieter and vibrate less than turboprop aircraft, thereby enhancing passenger comfort.

Regional Airline Market Segmentation

Industry analysts generally divide the regional airline market into five general segments for purposes of forecasting: turboprops, 20-39 seat jets, 40-59 seat jets, 60-80 seat jets and 81-110 seat jets. These segments have the following characteristics:

Market segment	10-year delivery forecast (2001-2010)	Percentage of market
Turboprops	853	18.4%
Jets:		
20-39 seat jets	719	15.5
40-59 seat jets	1,257	27.1
60-80 seat jets	844	18.2
81-110 seat jets	967	20.8
Subtotal jets	3,787	81.6
Total	4,640	100%

Turboprops. Demand for turboprop aircraft is expected to continue to decline over time. The Stanford/AvStat Report's 10-year outlook for the turboprop market estimates demand for 853 aircraft, representing an 18.4% share of the overall regional aircraft market. For airlines with relatively small fleets and short routes, turboprops represent the most economical alternative. Turboprops can also be economically favorable to larger airlines operating short-haul routes less than 400 nautical miles. It is also likely that markets with low passenger traffic will continue to require turboprop aircraft with capacities below those of the smallest jets, as will markets with locations where performance requirements, such as short runways and steep climb or descent profiles, favor turboprop aircraft.

20-39 seat jets. The first deliveries of a regional jet in this market segment occurred in June 1999 with the roll-out of the ERJ 135. The Stanford/AvStat Report's 10-year outlook for the 20-39 seat market estimates demand for 719 jet aircraft, representing a 15.5% share of the market. According to the ''Commercial Aircraft Orders and Deliveries—December 31, 2000'' report published by Speed News, Inc. on February 2, 2001, which we refer to as the Speed News report, a total of 161 firm orders have been placed for aircraft in this segment. Although turboprop aircraft currently dominate this market, we believe that lower operating costs associated with regional jets will make jet aircraft the preferred option for regional airlines.

40-59 seat jets. The 50-seat jet provides regional airlines with a fast, comfortable and cost efficient aircraft that in most instances works within scope clause limitations. According to the Stanford/AvStat Report, this segment is expected to see substantial growth in demand over the next 10 years, with deliveries of 1,257 jet aircraft, representing a 27.1% market share. According to the Speed News report, total firm orders are currently estimated at over 697 aircraft.

60-80 seat jets and 81-110 seat jets. The Stanford/AvStat Report forecasts deliveries in the next ten years of 844 new jet aircraft in the 60-80 seat market, representing an 18.2% market share, and 967 jet aircraft in the 81-110 seat market, representing a 20.8% market share. According to the Speed News report, total firm orders for the 60-110 seat jets market are currently estimated at 697 aircraft. We believe that rapid changes in regional airlines' operations and marketing agreements with major carriers will lead to increased use by major airlines of regional jets seating 70-100 passengers in routes formerly flown by DC-9, 737 and 727 aircraft. However, the market potential of this class in the United States is limited by scope clauses in the contracts of major airlines' pilots. These clauses, which are part of the agreements between the airlines and their pilots' unions, limit the maximum size and weight of aircraft that regional affiliates can operate. See ''Risk Factors—Risks Relating to the Regional Aircraft Industry.'' As a consequence, we believe that most of the demand in the United States for regional aircraft will be met with jets and turboprops seating up to 59 passengers. Most of the growth in the 60-110 seat segments is expected to occur in Europe, where scope clauses are less restrictive.

BUSINESS

We are the fourth largest manufacturer of commercial aircraft in the world based on 2000 net sales of commercial aircraft. We focus primarily on manufacturing regional aircraft. We are also the leading supplier of defense aircraft for the Brazilian Air Force based on number of aircraft sold. In addition, we are developing a new line of corporate jets based on our ERJ 135 regional jet.

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 jets with a strong global customer base. Including aircraft delivered and firm orders in backlog, at March 31, 2001, we had captured approximately 47% of the 20-59 seat regional jet market worldwide. We have sold our regional jets to 29 customers in 20 countries. Our customers include some of the largest regional airlines in the world, such as Continental Express, Crossair, American Eagle, Rio Sul, a subsidiary of Varig, and British Regional.

Aircraft Design; Cost and Operating Efficiency. We offer our aircraft at competitive prices and produce aircraft with reduced operating costs due to the similarity in design and the commonality of parts among jets within a regional jet 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. For example, several of our defense aircraft were developed based on our ERJ 145 regional jet, and our line of corporate jets is being developed based on the ERJ 135 regional jet. In addition, we design aircraft to be highly reliable and to permit easy access to parts and components, thereby decreasing maintenance costs while increasing operating efficiency for our customers. In addition, pilots need only to be trained on any one aircraft within a regional jet family in order to be certified to fly all the aircraft within that family. We believe that these factors will lead our customers to purchase more than one type of aircraft in each regional jet family.

Strategic Risk-Sharing Partners. With the ERJ 135/140/145 regional jet family, we developed strategic relationships with four key risk-sharing partners. These risk-sharing partners developed and manufactured significant portions of the aircraft, including the wings, tail, interior and parts of the fuselage. These partners contributed their own funds to research and develop the components used in our regional jet aircraft, thereby reducing our development costs. These risk-sharing partners also funded a portion of our development cost through direct contributions of cash or materials. We are following a similar strategy with the ERJ 170/190 regional jet family, although not with the same risk-sharing partners. In the ERJ 170/190 regional jet family, we will not only benefit from the contribution of risk-sharing partners to our development costs, but also from the assumption by risk-sharing partners of responsibility for the development, production and delivery to us of entire systems as well as major components. 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.

Strong Management. Since our privatization in 1994, our new management team has focused on developing new products, aggressively marketing our products internationally, enhancing customer service with on-site and regional customer support and regionally-based inventory distribution, and increasing operating efficiency. Under our management's direction, we have increased net sales from R$399.9 million in 1994 to R$5,417.5 million in 2000 and R$1,538.6 in the first three months of 2001, increased backlog from approximately US$729.0 million in 1994 to US$11.1 billion at March 31, 2001 and overcome eight consecutive years of operating and net losses by recording operating profits in 1996 and 1997 and operating and net profits in 1998, 1999 and 2000. Under our current management, we have significantly increased our productivity, with our net sales per employee increasing from R$64,310 in 1994 to R$562,600 in 2000.

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 turbofan technology developed for the Brazilian Air Force's AM-X program. In addition, we sell proven defense products developed for the Brazilian Air Force to other military forces.

Business Strategies

Develop 70-108 Seat Regional Jet Family. To meet the growing demand for larger regional jets, we are developing a 70-108 seat platform, the ERJ 170/190 regional jet family. This regional jet family will service higher traffic routes, enhancing our strong position in the regional jet market. We are developing the new ERJ 170/190 regional jet family under the same principles as the ERJ 135/140/145 regional jet family, utilizing risk-sharing partners, designing the new aircraft with a view toward commonality within the regional jet family and maintaining high quality and low development and operating costs. Additionally, we believe that our new 70-108 seat regional jet family will provide us with significant opportunities to increase our competitiveness by offering our customers a full range of regional aircraft. We plan to begin delivery of the ERJ 170 in late 2002 and of the ERJ 190 in mid-2004.

Develop Our Strategic Alliance with European Aerospace and Defense Group. We believe our strategic alliance with the European Aerospace and Defense Group will enhance both our defense and regional businesses and expand our global customer base.

- *Defense Market.* We believe that we will enhance our technological capabilities and will increase our production and marketing of innovative defense products. We also believe that we will increase our international marketing presence through joint marketing efforts with members of the European Aerospace and Defense Group.

- *Regional Market.* We believe that we will take advantage of synergies between our respective sales and service forces, particularly in Europe and Asia where the European Aerospace and Defense Group has established a presence. This strategic alliance should enable us to extend our sales reach and enhance our global customer service as well as to access customer support facilities 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. We have established four support centers worldwide. We have also outsourced distribution services through a facility in Weybridge, United Kingdom. We have established 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 those customers.

Increase Operating Efficiencies and Production Capacity. We have significantly increased our net sales per employee and have reduced aircraft production time of our regional jet aircraft from eight months in 1996 to 4.9 months in 2000. We have also increased the production rate of our regional jet aircraft from 12 per month at December 31, 1999 to 16 per month at March 31, 2001. We intend to increase the production rate to 20 per month by the end of 2001. We believe that we will be able to increase operating efficiency and production capacity through technological and capacity improvements in our production line and expansion of our facilities.

Expand Risk-Sharing Arrangements. We have expanded the role of risk-sharing arrangements in the production process for the ERJ 170/190 regional jet family in order to reduce production costs and streamline the management of our suppliers. Our risk-sharing partners have committed to provide us with entire systems for these aircraft, as opposed to individual components, thereby reducing the number 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.

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 also 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 and the EMB 145 MP.

Cost-Effectively Develop a Line of Corporate Jets. We are developing 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 regional airline travel. In developing the Legacy, we are using the same design and risk-sharing arrangements of our ERJ 135 regional jet. As a result, we are developing 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, in 1999, we formed a joint venture with Liebherr to develop and manufacture landing gear and high precision hydraulic equipment and to provide related services. We believe we can expand our business and enhance our products and technology through strategic transactions.

Strategic Alliance with European Aerospace and Defense Group

Sale of Shares

On November 5, 1999, the European Aerospace and Defense Group purchased 20% of all the outstanding common stock of Embraer from our existing common shareholders, a majority of which was from our controlling shareholders. The stock purchase by the European Aerospace and Defense Group of 20% of Embraer's common shares was completed in two steps. In the first step, there was a public tender offer conducted by Bozano, Simonsen S.A.—Corretora de Câmbio e Valores Mobiliários, at the time an affiliate of Cia. Bozano, for 36,000,000 common shares of Embraer. The price per common share was the amount in *reais* equivalent to US$4.30. All holders of common shares of Embraer were invited to tender during the offer period. The shares tendered were sold to the European Aerospace and Defense Group for US$154.8 million. Immediately after the conclusion of the public tender offer, Bozano, Simonsen Financial Holdings Ltd., currently known as Bozano Holdings Ltd., a selling shareholder, completed a private transaction with the European Aerospace and Defense Group for the sale of an additional 12,508,890 common shares of Embraer for an amount greater than US$4.30 per share.

We believe that the alliance will enable us to achieve three principal goals:

- Continue to develop and introduce new defense products, in particular those that may be required by the various branches of Brazilian Armed Forces, through the transfer of new technologies to Embraer;
- Increase market penetration both in our regional and defense businesses by taking advantage of the worldwide presence of the European Aerospace and Defense Group, especially in Asia; and
- Increase our sales and customer service forces by joining our sales forces and customer service facilities with those of the European Aerospace and Defense Group.

The European Aerospace and Defense Group is not a party to the shareholders' agreement among our controlling shareholders. As a result, the European Aerospace and Defense Group is not part of our group of controlling shareholders, which are PREVI, SISTEL and Cia. Bozano. When we jointly develop defense-related projects with any member of the European Aerospace and Defense Group, these projects will be submitted to the Brazilian government for its approval, as the holder of the "golden share."

Each of the members of the European Aerospace and Defense Group is briefly described below:

- *European Aeronautic, Defense and Space Company.* EADS is Europe's premier aerospace company and comprises the activities of the founding partners Aerospatiale Matra S.A. (France), Construcciones Aeronáuticas S.A. (Spain) and DaimlerChrysler Aerospace AG (Germany). EADS is the third largest aerospace company in the world, including one of the top manufacturers of commercial aircraft, helicopters, commercial space launchers and missiles. EADS is also a leading supplier of military aircraft, satellites and defense electronics. It employs 87,000 people at more than 90 sites in Germany, the United Kingdom, France and Spain.

- *Dassault Aviation.* Dassault Aviation is a leading producer of business jets and defense aircraft, including the Falcon business jet and the Mirage 2000 and Rafale fighter aircraft.

- *Thomson-CSF (Thales™).* Thales™ is a world leader in professional electronics for related commercial and defense markets. Thales™ develops and supports advanced electronic equipment and systems to meet security, information and communication needs throughout the world. Its activities encompass everything from components to large-scale systems for all sectors where electronics and computing technologies play a crucial role.

- *Société Nationale d'Étude et de Construction de Moteurs d'Aviation.* SNECMA, the French aircraft engine manufacturer, is involved in a wide range of activities, including manufacturing civil and military aircraft engine components and spacecraft engines and equipment, such as landing gear, brakes, reversers and nacelles, regulation systems and transmissions, and providing engine repair and braking systems repair services. The CFM56 engine is designed, built and marketed by SNECMA and General Electric, through their jointly-owned subsidiary, CFM International. Defense products include engines that power the Mirage 2000 and Rafale fighter aircraft.

History

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 jet and turboprop aircraft for commercial 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 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.

Our first major regional aircraft was the Bandeirante, a 19-passenger twin engine depressurized propeller 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 135/140/145 regional jet family, our first jet product for commercial use. We are expanding our regional jet product offering with the development of the ERJ 170/190 regional jet family, designed to serve the regional aircraft market's trend towards larger, higher volume and longer range regional jets. We are also marketing and selling a line of corporate jets based on our ERJ 135 regional jet.

Originally formed in 1969 by the Brazilian government, as a *sociedade por quotas de responsabilidade limitada*, a limited liability corporation, we were privatized by the Brazilian government in 1994. In connection with our privatization, we were transformed into a *sociedade por ações*, a corporation with limited liability. We are subject to the Brazilian corporation law. Our controlling shareholders include Cia. Bozano and two major Brazilian pension funds: PREVI and SISTEL. Our other principal shareholders include the members of the European Aerospace and Defense Group. The Brazilian government remains a minority shareholder and retains a ''golden share,'' entitling it to control of defense technology developed by us and the power to veto major corporate actions. See ''Description of Capital Stock.''

On July 26, 2000, we, Cia. Bozano, SISTEL, PREVI and BNDESPAR completed Embraer's global equity offering, in which we collectively sold 22,050,000 ADSs, representing 88,200,000 preferred shares, in an international offering and 8,400,000 preferred shares in a Brazilian offering. In these public offerings, Embraer sold 11,880,000 ADSs, representing 47,520,000 preferred shares, in the international offering and 5,280,000 preferred shares in the Brazilian offering. Each of Cia. Bozano, SISTEL and PREVI sold 2,659,500 ADSs, representing 10,638,000 preferred shares, in the international offering and 832,000 preferred shares in the Brazilian offering. BNDESPAR sold 2,191,500 ADSs, representing 8,766,000 preferred shares, in the international offering and 624,000 preferred shares in the Brazilian offering.

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,			Three months ended March 31,	
	1998	1999	2000	2000	2001
			(in millions of reais)		
Regional Aircraft:					
Americas (excluding Brazil)	R$1,219.5	R$2,399.7	R$2,562.9	R$ 463.1	R$ 570.0
Europe	303.1	852.6	2,141.9	537.8	742.9
Brazil	126.1	114.6	—	—	37.6
Others	—	—	109.3	—	37.0
Total	R$1,648.7	R$3,366.9	R$4,814.1	R$1,000.9	R$1,387.5
Corporate Jets					
Americas (excluding Brazil)	—	—	R$ 52.9	—	—
Europe	—	—	—	—	—
Brazil	—	—	—	—	—
Total	—	—	R$ 52.9	—	—
Defense Aircraft					
Americas (excluding Brazil)	R$ —	R$ 6.0	R$ —	R$ —	R$ —
Europe	5.2	—	54.4(1)	31.5	14.4
Brazil	195.5	233.6	129.8	33.0	30.0
Others	36.6	—	—	—	—
Total	R$ 237.3	R$ 239.6	R$ 184.2	R$ 64.5	R$ 44.4
Other Related Business	R$ 218.6	R$ 453.3	R$ 366.3	R$ 74.7	R$ 106.7

(1) Includes R$31.0 million of net sales relating to the sale of one ERJ 135 aircraft to the Greek government for use as a corporate jet.

Regional Aircraft Business

We design, develop and manufacture a range of regional aircraft. Our regional aircraft business is our primary business, accounting for 88.9% and 90.2% of our net sales for the year ended December 31, 2000 and the three months ended March 31, 2001.

Products

We developed the ERJ 145, a 50-passenger twin turbofan-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 of 1999. In addition, we are developing a new regional jet as part of the ERJ 135/140/145 regional jet family, the 44-seat ERJ 140, which we expect to begin to deliver in the second half of 2001. We believe that the ERJ 135/140/145 regional jet family provides the comfort, range and speed of a jet at costs comparable to turboprop aircraft. As of March 31, 2001, we had received 835 firm orders from 28 customers for this regional jet family, of which we have delivered 391 regional aircraft and have a backlog of 444 regional aircraft including major commitments from Continental Express and American Eagle. At March 31, 2001, we had captured 47% of the 20-59 seat regional jet market worldwide, including aircraft delivered and firm orders in backlog.

We are currently developing a new 70-108 seat platform, the ERJ 170/190 regional jet family, to serve the trend in the regional aircraft market toward larger, faster and longer range regional jets and to further diversify our strength in the regional jet market. As of March 31, 2001, we had received 120 firm orders from three customers for this new regional jet family. At March 31, 2001, we had captured 18% of the 60-90 seat regional jet and 5% of the 91-120 seat regional jet markets worldwide, including aircraft delivered and firm orders in backlog. We continue to analyze new aircraft demand in the regional market to determine potentially successful modifications to aircraft we already produce.

ERJ 145

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 and the European aviation authority in May 1997. We began delivering the ERJ 145 in December 1996 and, as of March 31, 2001, we had delivered 316 aircraft.

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. To develop and manufacture the ERJ 145, we entered into agreements with four risk-sharing partners. The total research and development costs for the ERJ 135/140/145 regional jet family at March 31, 2001 was R$693.5 million, of which we received total cash and material contributions of R$70.2 million from four risk-sharing partners and other major suppliers. We also benefited from design and development of the systems for which these risk-sharing partners were responsible. Our partnering and supplier relationships have allowed us to lower appreciably our development and production costs. See ''—Suppliers and Components; Risk-Sharing Arrangements.''

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, due to their fuel efficiency, operate at a lower cost than the engines of comparable jet aircraft. In addition, the ERJ 145 is equipped with state-of-the-art 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 customers' requests, we are developing a new 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, FAA and 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 we expect to be certified by the Brazilian aviation authority, FAA and European aviation authority in the beginning of 2002, will offer reduced fuel consumption, a maximum fully loaded range of 2,000 nautical miles and enhanced operational capabilities for hot weather and at high altitudes. We expect to commence first deliveries of the ERJ 145 XR in the second quarter of 2002.

ERJ 135

The ERJ 135 is a 37-seat regional jet based on the same design as the ERJ 145. Both the ERJ 145 and the ERJ 135 are 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 135/140/145 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 and, at March 31, 2001, we had delivered 75 aircraft.

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, state-of-the-art 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.

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 (l,700 nautical miles) than the standard version. The LR version received certification simultaneously with the standard version.

ERJ 140

We are developing 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 will be manufactured on the same production line as the ERJ 145 and ERJ 135. The ERJ 140 will also have approximately 96% commonality with the ERJ 145 and ERJ 135, providing our customers with significant maintenance and operational benefits. The ERJ 140 is currently undergoing the certification process in Brazil and the United States, which we expect will be completed prior to our first scheduled deliveries in the second half of 2001. The ERJ 140 has a maximum fully loaded range of 1,230 nautical miles in its standard version. The ERJ 140 will also be 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.

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 March 31, 2001, we have delivered 345 EMB 120 Brasílias for the regional market and five EMB 120 Brasílias for the defense market and have captured 25% of the 20-39 seat turboprop aircraft market worldwide, including aircraft delivered and firm orders in backlog. We currently manufacture the EMB 120 Brasília only upon customer request.

ERJ 170/190

The ERJ 170/190 regional jet family provides our customers with a choice of several aircraft in the 70-108 passenger range. The ERJ 170 will be a 70-passenger regional jet, while the ERJ 190 series will include the 98-passenger ERJ 190-100 and the 108-passenger ERJ 190-200. At March 31, 2001, we had 120 firm orders for this new regional jet family, including 60 firm orders from Swiss regional carrier Crossair, our launch customer for this new product and Europe's largest regional airline, and 50 firm orders from GE Capital Aviation Services. We are developing the ERJ 170/190 regional jet family together with risk-sharing partners, including General Electric and Honeywell, which will be supplying key systems for these aircraft. To cover part of our capital expenditures, our risk-sharing partners will contribute to us a total of US$256 million in cash, of which we have already received US$145.8 million as of March 31, 2001.

We completed the joint design definition phase of the ERJ 170 development process in March 2000 and are beginning the joint design definition phase of the ERJ 190 development process. We expect to commence delivery of the ERJ 170 in December 2002, the ERJ 190-200 in July 2004 and the ERJ 190-100 in 2005. This new regional jet family, unlike our ERJ 135/140/145 regional jet family, will have engines fixed under its main wings—a design intended to enhance power, improve fuel economy and minimize turnaround times. Because the ERJ 170/190 regional jet family is in the development stage, we cannot assure you that the program will ever be completed successfully or that, if it is completed, it will be profitable.

We designed the ERJ 170/190 regional jet family to maximize the benefits of commonality, with aircraft in the family sharing approximately 80% of the same components. The high level of commonality in this new regional 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 ERJ 170/190 regional jet family will not share the same wing design. Both aircraft models will be powered by engines manufactured by General Electric and will contain state-of-the-art avionics manufactured by Honeywell.

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

- *Performance.* All three jets in the ERJ 170/190 regional jet family will have a maximum cruising speed of Mach .8, or 470 knots. The ERJ 170 will have a maximum fully loaded range of 1,800 nautical miles and will be available in a long-range, or LR, version, with a maximum fully loaded range of 2,100 nautical miles. The ERJ 190-100 and ERJ 190-200 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 three jets in the ERJ 170/190 regional 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 takes into account accessibility and efficiency of ground services.
- *Cabin and cargo space.* We have enhanced passenger safety and comfort in the ERJ 170/190 regional 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 and planned 70-110 seat regional jet aircraft of our competitors.

Customers

While we have focused our efforts on the U.S. and European markets, which we believe represent the most significant growth opportunities, we have achieved a diverse, global customer base for our aircraft, principally in the regional jet market. The following table shows, at March 31, 2001, the breadth of our global customer base for our principal regional aircraft:

Geographic location/aircraft type	Number of aircraft delivered and firm backlog(1)	Number of customers
United States		
ERJ 145	374	5
ERJ 135	90	2
ERJ 140	139	1
ERJ 170	50	1
EMB 120 Brasília	263	9
Brazil		
ERJ 145	16	1
EMB 120 Brasília	24	8
Europe		
ERJ 145	153	17
ERJ 135	21	4
ERJ 170	40	2
ERJ 190	30	1
EMB 120 Brasília	47	8
Other		
ERJ 145	7	2
ERJ 135	35	2
EMB 120 Brasília	13	6

(1) Includes all aircraft delivered since inception of each aircraft type.

Our major customers of regional aircraft include some of the largest regional airlines in the world, such as Continental Express, Crossair, American Eagle, Mesa Airlines, Rio Sul, a subsidiary of Varig, and British Regional. Our largest customers are Continental Express and American Eagle, which together accounted for approximately 43% and 27% of our net sales of regional jet aircraft for the year ended December 31, 2000 and the three months ended March 31, 2001. At March 31, 2001, 63.7% of our firm orders in backlog and 37.0% of our options for the ERJ 145 were attributable to Continental Express and American Eagle. Similarly, at March 31, 2001, 35.2% of our firm orders in backlog for the ERJ 135 were from Continental Express. At March 31, 2001, all of our firm orders and options for the ERJ 140 were from American Eagle. In addition, at March 31, 2001, 91.7% of our firm orders in backlog and 97.6% of our options for the ERJ 170/190 were attributable to GE Capital Aviation Services and Crossair.

We generally sell our regional aircraft pursuant to contracts with our customers on a fixed-price basis, adjusted by an escalation formula which 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 residual value guarantees in favor of our customers. See "Risk Factors—Risks Relating to Embraer—Our aircraft sales are subject to cancellation provisions, repurchase and trade-in options and residual value guarantees in favor of our customers that may reduce our cash flow or require us to make significant cash distributions 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.

Backlog, New Orders and Options

At March 31, 2001, we had a backlog of US$11.1 billion of additional net sales, including 564 regional jets. In addition, at the same date, we had options for 607 regional aircraft, representing approximately US$11.4 billion of potential additional net sales. We expect to deliver US$2.5 billion of our backlog by the end of 2001.

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 and a down payment from our customer. Our backlog excludes options and letters of intent for which definitive contracts have not been executed. We receive progress payments for each firm order. 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. We receive the remaining amount of the sales price upon delivery of the aircraft. The deposits and the progress payments are generally non-refundable. We monitor the condition of our backlog and believe, based on our customer profile and our historical experience, that there will not be a significant number of cancellations. We cannot assure you that our current backlog will necessarily lead to sales in the future.

With respect to options to purchase our aircraft, we customarily receive US$100,000 for each ERJ 135/140/145, US$200,000 for each ERJ 170/190 and US$50,000 for each EMB 120 Brasília. 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. We typically give our customers 18 months prior to the scheduled delivery date of the option aircraft to exercise their options. Once a customer decides to exercise an option, we account for it as a firm order. To date, most of the options placed on our regional aircraft have been exercised. On occasion, we have extended the exercise date for our options. We cannot assure you that these options will ultimately be exercised or that these options will necessarily lead to sales in the future. 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. For example, American Eagle converted six options for the ERJ 135 into options for the ERJ 145 aircraft and 133 firm orders and 31 options for the ERJ 135 into the same number of firm orders and options for the ERJ 140 aircraft.

The following table summarizes our sales order book, at March 31, 2001, for each of the ERJ 145, ERJ 135, ERJ 140, ERJ 170 and ERJ 190.

ERJ 145

Customer	Country	Firm Orders	Options	Deliveries	Firm Order Backlog
Air Caraibes	Guadalupe	2	—	2	—
Air Moldova	Moldova	2	2	—	2
Alitália	Italy	8	13	6	2
American Eagle	USA	56	17	50	6
Axon Airlines	Greece	4	2	—	4
British Midland	United Kingdom	10	6	7	3
British Regional	United Kingdom	23	3	18	5
Brymon	United Kingdom	7	14	7	—
Cirrus	Germany	1	—	1	—
Continental Express	USA	225	100	82	143
Crossair	Switzerland	25	15	12	13
ERA	Spain	2	—	2	—
KLM Exel	The Netherlands	3	2	2	1
LOT	Poland	16	—	12	4
Luxair	Luxembourg	9	2	9	—
Mesa Airlines	USA	36	64	14	22
Portugália	Portugal	8	—	8	—
Proteus	France	13	—	10	3
Regional Airlines	France	15	—	12	3
Rheintalflug	Austria	3	5	3	—
Rio Sul	Brazil	16	15	16	—
Sichuan Airlines	China	5	—	4	1
Skyways AB	Sweden	4	11	4	—
Trans States	USA	12	—	12	—
Wexford	USA	45	45	23	22
Total		550	316	316	234

ERJ 135

Customer	Country	Firm Orders	Options	Deliveries	Firm Order Backlog
American Eagle	USA	40	—	40	—
British Midland	United Kingdom	4	—	—	4
City Air	Sweden	2	1	1	1
Continental Express	USA	50	—	25	25
Proteus	France	10	15	6	4
Regional Airlines	France	5	—	3	2
Regional Air Lines	Morocco	5	5	—	5
SA Airlink	South Africa	30	40	—	30
Total		146	61	75	71

ERJ 140

Customer	Country	Firm Orders	Options	Deliveries	Firm Order Backlog
American Eagle	USA	139	25	—	139

ERJ 170

Customer	Country	Firm Orders	Options	Deliveries	Firm Order Backlog
Crossair(1)	Switzerland	30	50	—	30
GECAS	USA	50	78	—	50
Regional Airlines	France	10	5	—	10
Total		90	133	—	90

ERJ 190

Customer	Country	Firm Orders	Options	Deliveries	Firm Order Backlog
Crossair(1)	Switzerland	30	50	—	30
GECAS	USA	—	22	—	—
Total		30	72	—	30

(1) Options for 100 aircraft are exercisable for either the ERJ 170 or the ERJ 190.

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. See ''Risk Factors—Risks Related to Embraer—We face significant international competition, which may adversely affect our market share.'' In the 20-39 seat category, the main competitors of the ERJ 135 and the EMB 120 Brasília aircraft are the Fairchild Dornier 328JET, the De Havilland DHC-8-200 and the Fairchild Dornier 328. Of these, only the Fairchild Dornier 328JET is a jet aircraft. In the 40-59-seat category, the main competitors of the ERJ 145 and the ERJ 140 aircraft are the CRJ-100/200, manufactured by Bombardier, the ATR-42, manufactured by ATR G.I.E., a joint project of Italy's Alenia Aerospaziale and EADS, and De Havilland's DHC-8-300. Of these competing aircraft, only Bombardier's CRJ-100/200 is a jet aircraft. 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 135/140/145 family.

In the 60-80 and 81-110 seat categories, we face our strongest competition. Currently, there are five aircraft in the segment, British Aerospace plc's Avro RJ85 and RJ100 jets, 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 is expected to enter service in 2003, before the delivery of our ERJ 190 series. Fairchild Dornier is developing 70- and 90-seat regional jets, the 728JET, which could come to market in 2003, and the 928JET, which could come to market in 2004. In the larger end of the category, Boeing has launched the 717-200, a 106-112 seat jet. Furthermore, Airbus is developing a 100+ seat jet, the A318, which is expected to be in service in 2002.

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 and available subsidies, 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 March 31, 2001, we had sold 514 defense aircraft to the Brazilian government and 520 defense aircraft to other military forces. Our defense business accounted for 3.4% of our net sales for the year ended December 31, 2000 and 2.9% of our net sales for the three months ended March 31, 2001.

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 subsequently developed the Super Tucano and are developing 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 and we have not received any firm orders for this aircraft. The AL-X is being developed under a contract with the Brazilian Air Force, with FINEP providing R$24.5 million in funded research and development. The AL-X is a turboprop equipped with an engine with twice the power of the Tucano's standard engine, sophisticated navigation and attack systems, night operations capability and the ability to operate under severe weather conditions. We expect to deliver approximately 100 of these aircraft to 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 2002. 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 March 31, 2001, the Brazilian government had ordered a total of eight EMB 145 AEW&C/RS/MP aircraft to conduct surveillance and monitor ground activities in the Amazon region. In October 1999, the Greek government, represented by the Hellenic Air Force, executed a contract for the supply of 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 January 2000, the Mexican government selected Embraer to supply 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 Finmecanica 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 supply each other with different key components and systems of the aircraft. Each of Embraer and the Italian partners is free to market the aircraft independently and receives 100% of the proceeds of its sales. Approximately 190 AM-X aircraft are currently in operation in the air forces of Brazil and Italy.

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 in the amount of US$150.0 million, all of which will be received by Embraer.

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.'' We have also entered into a contract with the Belgian Air Force for two ERJ 135s and two ERJ 145s modified to transport government officials. 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.

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 are developing a new 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 1.0% of our net sales for the year ended December 31, 2000, resulting from the delivery of two ERJ 135s to the corporate market, as compared to no corporate jet deliveries for the three months ended March 31, 2001.

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. In December 2000, we delivered two corporate jets. At March 31, 2001, we had 30 firm orders and 31 options for the Legacy, of which 25 firm orders and 25 options were from Swift Aviation, the launch customer for the Legacy.

According to a report by Teal Group Corporation, published in July 1999, a total of 1,430 deliveries of aircraft in the anticipated market segments for the Legacy are expected worldwide between 1999-2008.

We are developing 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 will have the same components as the ERJ 135 and will be capable of being manufactured on the same production line. Furthermore, the corporate shuttle version of the Legacy will not require separate FAA, European aviation authority or Brazilian aviation authority approval. 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, Raytheon and Fairchild Dornier.

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 and a down payment from our customer. 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 6.8% of our net sales for the year ended December 31, 2000 and 6.9% of our net sales for the three months ended March 31, 2001.

We have 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. On November 26, 1999, we formed a new subsidiary, Embraer Liebherr Equipamentos do Brasil S.A., also known as 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. We have retained some liabilities and obligations related to our landing gear manufacturing activities that we transferred to ELEB. On May 22, 2000, Liebherr International AG, acting in coordination with its subsidiary, Liebherr Aerospace Andenberg GmbH, a German company, and through its Brazilian affiliate, Liebherr Participações Brasil Ltda., subscribed for 40% of the capital stock of ELEB.

In the agreement with Liebherr International AG, we have agreed to provide ELEB with loans in the total amount of R$3.8 million at an annual interest rate equal to 12% for working capital and investment purposes related to the activities to be performed by ELEB. We have also agreed not to compete with ELEB’s business. Liehherr Aerospace, currently our risk-sharing partner responsible for designing, developing and manufacturing the landing gear assemblies for the new ERJ 170/190 regional jet family, is part of a German group active in diverse activities, including civil construction projects, machine and tools manufacturing and development of aerospace technology.

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 has grown and is expected to continue to grow significantly as the number of our aircraft in service grows. For example, net sales from spare parts has grown from R$185.4 million in 1998 to R$331.4 million in 2000. 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. As we deliver the aircraft we have in our backlog, we expect our after-sales support and spare parts business to grow proportionately. We have established four support centers worldwide. We have also outsourced distribution services through a facility in Weybridge, United Kingdom. See ''—Customer Service and Product Support.''

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 act as a risk-sharing partner to Sikorsky. We have incurred research and development costs of R$25.1 million for this program through March 31, 2001, and we anticipate incurring an additional US$1.7 million through the end of 2001. Net sales from the equipment manufacturing contracts with Sikorsky are valued, over the life of the contracts, at approximately US$300 million. 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 March 31, 2001, we had delivered a total of 2,326 of these aircraft.

We also developed a crop duster aircraft pursuant to specifications of the Brazilian Ministry of Agriculture. These aircraft are produced only on demand. At March 31, 2001, we had delivered a total of 828 of these aircraft.

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 prefabricated 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 aircraft production time of our regional jet aircraft from eight months in 1996 to 4.9 months in 2000. 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 intend to increase this production rate to 20 aircraft per month by the end of 2001. In addition, we build the EMB 120 Brasília according to market demand and adjust production accordingly. To accommodate our increased production of the ERJ 135/140/145 regional jet family and the start of production of the ERJ 170/190 regional jet family, as well as any production of the line of corporate jets, we are expanding our production facilities, acquiring new facilities, coordinating with risk-sharing partners and suppliers and hiring additional employees. See ''Risk Factors—Risks Relating to Embraer.'' We face a number of production and personnel challenges that could lead to delays in deliveries of our aircraft.

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. This facility will consist of a runway and other features to handle our development of supersonic aircraft technology, as well as to handle flight tests for our ERJ 170/190 regional jet family. We expect the runway to be finalized by the end of 2001 and the balance of this facility to be operational by the end of 2002. 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. For additional information on these new facilities, see ''Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources.''

Suppliers and Components; Risk-Sharing Arrangements

We do not manufacture all of the parts and components used in the production of our aircraft. Approximately 79% to 85% of the production costs of our ERJ 135/140/145 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.

Although we select our risk-sharing partners and suppliers based on overall aircraft systems requirements, quality, production capacity and competitiveness in the market, 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, and although we maintain business interruption insurance to cover such a disruption, 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.

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 135/140/145

Risk-sharing partners. We entered into risk-sharing arrangements with the following four suppliers in connection with the development and production of the ERJ 135/140/145 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 Aerospatiales, 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. We received total cash and material contributions of R$70.2 million from these risk-sharing partners to help fund our total research and development costs for the ERJ 135/140/145 regional jet family. The partnering relationship with these suppliers results in lower production costs and higher product quality for the ERJ 135/140/145 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. To date, we have not experienced any significant delays in deliveries from risk-sharing partners which have caused any delays in our delivery schedule.

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 135/140/145 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. Because we test products from several manufacturers during the development phase of an aircraft, we believe that we will be able to contract with backup suppliers on a timely basis in the event a problem arises with a supplier.

ERJ 170/190

We are developing the ERJ 170 and the ERJ 190 together with risk-sharing partners that will supply key systems for the aircraft. Our supplier arrangements for the ERJ 170/190 regional jet family will differ from the ERJ 135/140/145 regional jet family in that we intend to use fewer suppliers. In the ERJ 170/190 regional 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 ERJ 170/190 regional jet family are the following:

- General Electric will supply CF34-8E/l0E turbofans as the ERJ 170/190's engines and will also be in charge of designing, developing and manufacturing the engine nacelles;
- Honeywell will supply the avionics systems;
- Liebherr will be responsible for designing, developing and manufacturing the new regional jets' landing gear assemblies;
- Kawasaki, a Japanese company, will develop and manufacture 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., will develop and produce the aircraft's tail core, auxiliary power unit, electrical systems and the air management system;
- Sonaca will be responsible for the aircraft's wing slats;
- Gamesa will be responsible for the rear fuselage and the vertical and horizontal tail surfaces;
- Latecoere, a French company, will manufacture two of the three fuselage sections;
- C&D Aerospace will design, develop and manufacture the aircraft interior; and
- Grimes Aerospace Company, a U.S. company and a wholly owned subsidiary of AlliedSignal Inc., will develop and manufacture the exterior and cockpit lighting.

Our risk-sharing partners will contribute to us a total of US$256 million in cash, of which we have already received US$145.8 million as of March 31, 2001, in addition to the design and development of the systems for which they are responsible. If we cancel the development of the ERJ 170/190 regional 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. 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, the risk-sharing partners for the ERJ 170/190 regional 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 four 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. Through our customer focus, we aim to enhance customer loyalty and, ultimately, increase sales.

We 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, copilots, flight attendants and mechanics at these locations. We operate advanced flight simulators for our ERJ 135/140/145 regional jet family and for the Legacy at our U.S. 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 ERJ 170/190 regional 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.

Aircraft Financing Arrangements

We do not provide direct financing 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.

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 68.4% of the firm orders (in terms of value) we had with our customers at March 31, 2001. 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, purchase our aircraft and lease it to our customer.

The BNDES-*exim* program, a Brazilian government-sponsored program, provides our customers with direct financing for Brazilian exports of goods and services. At March 31, 2001, approximately 31.6% of our backlog (in terms of value) will be 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. In July 1998, the Canadian government initiated a proceeding with the 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 adopted the decision on August 20, 1999, giving 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 November 19, 1999, the Brazilian and Canadian governments presented to the dispute resolution body of the WTO the modifications that they made to bring their respective programs into compliance with the WTO rulings. Both countries then declared that the other's modifications were unsatisfactory and did not comply with the WTO rulings.

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 after November 18, 1999 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 its earlier decision after an appeal by the Brazilian government. The Brazilian government publicly announced that it intends to honor its contractual commitments to our customers. However, we cannot assure you that the Brazilian government will, in fact, honor its contractual commitments to our customers, or that, if it does, its trade relations with Canada or other countries will not suffer. The Brazilian government also announced that it would further amend the ProEx program to provide that any ProEx payments would not decrease the effective interest rate below the commercial interest reference rate permitted by the WTO without proof that the actual market interest rate is lower than the commercial interest reference rate. Canada is challenging the Brazilian government's interpretation of the scope of application of the WTO's effective interest rate restrictions.

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. In addition, the Canadian government has 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. Brazil is challenging this financing before the WTO. We expect to receive the WTO's decisions on these challenges beginning in early June 2001.

We cannot predict the outcome of any resolution of these disputes. See ''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.''

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. However, there is a proposed law under analysis in the Brazilian Congress that aims at the extinction of the DAC and its substitution by a 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 Brazil and in other countries in which our customers are located must certify our aircraft before we can sell them, including the Brazilian aviation authority, the FAA, 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 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 is currently undergoing the certification process in Brazil and the United States, which we expect will be completed prior to our first scheduled deliveries in the second half of 2001. The ERJ 170/190 regional jet family will undergo the complete certification process once production begins. The executive version of our corporate jets will require certification prior to first deliveries in the second half of 2001. See ''Risk Factors—Risks Relating to the Regional Aircraft Industry—We are subject to stringent certification requirements and regulation, which may delay our obtaining certification in a timely manner.''

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 European aviation authority. The European aviation authority 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 European aviation authority 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 European aviation authority's recommendations as it sees fit. The European aviation authority is expected to be replaced by 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.

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.

Employees

We employed a total of 6,737, 8,302, 10,334 and 11,481 people at December 31, 1998, 1999 and 2000 and March 31, 2001, respectively. Of the total workforce at March 31, 2001, 54.2% are directly involved in the production process, 13.4% are engaged in research and development, 10.3% 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 large 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 March 31, 2001, approximately 76.8% of our employees were non-union, compared to approximately 52% in December 1997. 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.

Properties

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. and security interests relating to pending labor claims. 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 facilities and support center	5,902,102	Owned	—
São José dos Campos, SP, Brazil (Eugênio de Mello)	Industrial site	3,658,884	Owned	—
Botucatu, SP, Brazil	Manufacturing facilities	222,000	Owned	—
Gavião Peixoto, SP, Brazil	Testing and manufacturing facilities	191,648,512	*	—
São Paulo, SP, Brazil	Administrative offices	2,160	Leased	2002
Ft. Lauderdale, Florida, U.S.A.	Support center	91,500	Leased	2002
West Palm Beach, Florida, U.S.A.	Engineering offices	16,800	Leased	2005
Dallas, Texas, U.S.A.	Administrative offices	1,600	Leased	2003
Le Bourget, France	Support center	33,500	Leased	2008
Melbourne, Australia	Support center	12,126	Leased	2002
Beijing, China	Representative offices	1,709	Leased	2002
Singapore	Representative offices	2,239	Leased	2002

* 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.

Intellectual Property

Our intellectual property, which includes patents, designs, 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 with the Brazilian Institute of Industrial Property and the governmental authorities of countries where our aircraft are operating. At March 31, 2001, we had approximately 69 trademarks. The patent coverage on our most important technologies will not expire within the next six years. We do not believe that the expiration of any of our patents would have a material adverse effect on our business. Brazil provides mechanisms to protect patents and trademarks that are similar to the federal registration systems available in the United States.

Environmental Matters

Most environmental regulation in Brazil is established at the state rather than 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 1999 and 2000, we invested R$800,548 and R$1.4 million in environmental matters, respectively, and we anticipate spending approximately R$2.4 million on environmental matters in 2001. This increase is due to expenditures relating to the portion of construction of new facilities and modification of existing facilities relating to environmental compliance and improvements.

Legal Proceedings

We have a number of labor-related lawsuits brought by the workers' union representing some of our former employees with claims in an aggregate amount of approximately R$85.7 million at March 31, 2001, for which we had provisioned approximately R$15.3 million at such date. Our management considers these amounts to represent a reasonable estimate of future payment on settlement or resolution of these lawsuits. We also 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.

Below are the major legal proceedings in which we were involved as of the date of this prospectus:

Adverse Party	Date Instituted	Allegation/Relief Sought	Court in which Pending
Workers' Union on behalf of 7,283 current and former employees(1)	October 1992	Payment of salary differences based on agreements between the labor unions and FIESP	Superior Labor Court
Brazilian Fiscal Agency(2)	February 1999	Challenge of the application of the sales tax rate to our revenues other than gross sales	Federal Court in São José dos Campos

(1) The total exposure for payment of retroactive salaries was R$62.0 million on March 31, 2001. At March 31, 2001, we had not provisioned any amounts for this lawsuit because, we believe that this lawsuit is not likely to result in a decision adverse to us. We do not expect final judgment to occur before the second half of 2001.

(2) We have not paid the additional taxes. The unpaid amounts were R$59.5 million on March 31, 2001 and are included as a liability in our balance sheet, under taxes and social charges payable.

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 "Risk Factors—Risks Relating to Embraer—We may have to make significant payments as a result of unfavorable outcomes of pending litigation" and note 17 to our audited financial statements for a further discussion of the legal proceedings we face.

MANAGEMENT

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

Under the Brazilian corporation law, each member of the board of directors must hold at least one of our common or preferred shares, may reside outside of Brazil, and is elected by the holders of our common shares at the *Assembléia Geral*, or the general shareholders' meeting. There are no provisions in our bylaws regarding a director's power to vote on a proposal, arrangement or contract in which such director is materially interested, or the borrowing powers exercisable by our directors; nor do our bylaws set forth an age limit requirement for retirement of our directors. However, under the Brazilian corporation law, a director is prohibited from voting in any meeting or with respect to any transaction in which he has a conflict of interest with the company. According to our bylaws, the Brazilian government, as holder of the golden share, has the right to appoint one member of the board of directors, and our employees have the right to appoint two members of the board of directors to be elected by the holders of our common shares. 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 April 30, 2001.

Our bylaws provide that the President 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 appoint 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 ''Principal and Selling Shareholders—Principal Shareholders'' for more information on the shareholders' agreement.

Name	Age	Position	Year First Elected
Carlyle Wilson	72	Chairman of the Board of Directors	2000
Nélio Henriques Lima	49	Deputy-Chairman of the Board of Directors	2001
Maurício Novis Botelho	58	President and Chief Executive Officer	2000
Vitor Sarquis Hallack	48	Member of the Board of Directors	1995
Andrea Sandro Calabi	55	Member of the Board of Directors	2001
Juarez Martinho Quadros do Nascimento	57	Member of the Board of Directors	1998
Fernando Antônio Pimentel de Melo	47	Member of the Board of Directors	2000
Luiz Felipe P. Lampreia	59	Member of the Board of Directors	2001
Reginaldo dos Santos	59	Member of the Board of Directors	2001
Paulo Cesar de Souza Lucas	41	Member of the Board of Directors	1999
Mario Hipólito Silva	36	Member of the Board of Directors	2001
Pierre Chouzenoux	62	Member of the Board of Directors	2000
Dietrich Russell	59	Member of the Board of Directors	2000

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 and 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 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.

Andrea Sandro Calabi. Mr. Calabi has been a member of the board of directors of CEF-Caixa Econômica Federal since May 1999 and is a managing partner of AACC-Administração e Consultoria S/C Ltda, a consulting firm. From November 1996 to December 1998, he was a managing partner of CONSEMP-Serviços Empresariais Ltda. Mr. Calabi was an executive secretary of the Ministry of Planning of the Brazilian government from January 1995 to September 1996. Mr. Calabi was a member of the board of directors of BNDES and Banco do Brasil, as well as a member of several governmental boards, during 1995 and 1996. From December 1996 to December 1998, he was a member of the board of directors of Companhia Paulista de Ativos-CPA and from May 1998 until December 1998, he was a member of the board of directors of BANESPA-Banco do Estado de São Paulo S.A., a financial institution. Further, from January 1999 to July 1999, Mr. Calabi was the President of Banco do Brasil and chairman of the board of directors of BRASILPREV Previdência Privada, BRASILCAP Capitalização S.A., BrasilSaúde Companhia de Seguros, Companhia de Seguros Aliança do Brasil and BrasilVeículos Companhia de Seguros, all affiliates of Banco do Brasil. From July 1999 to February 2000, Mr. Calabi was the President and a board member of BNDES, FINAME and BNDESPAR and a member of the board of directors of Petróleo Brasileiro S.A.—Petrobras, an oil company. Mr. Calabi is a representative of PREVI, and his business address is Rua Viradouro, 63, Suite 61, 04538-110 São Paulo, SP, Brazil.

Juarez Martinho Quadros do Nascimento. Mr. Nascimento has been an 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, since 1997. 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 Esplanada dos Ministérios, Bloco ''R,'' 8th floor, 70044-900 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, Americel S.A, since April 27, 1999, and Telet S.A., since April 26, 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' 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.

Pierre Chouzenoux. Mr. Chouzenoux is Managing Director of Dassault International and has been the Senior Vice President of International Affairs of Dassault Aviation since 1993. From 1990 to 1993, Mr. Chouzenoux was the General Manager for Social Affairs of Dassault Aviation. Prior to 1990, Mr. Chouzenoux held various executive positions with the Elf Aquitaine Group. Mr. Chouzenoux is a representative of the European Aerospace and Defense Group, and his business address is 78 Quai Marcel Dassault, 92210 Saint-Cloud, France.

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 Civil Aircraft and Helicopters Group of the 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.

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 one-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 April 30, 2001.

Name	Age	Position	Year First Elected
Maurício Novis Botelho	58	President, Chief Executive Officer and Director	1995
Antonio Luiz Pizarro Manso	56	Executive Corporate Vice-President	1995
Satoshi Yokota	60	Executive Vice-President—Industrial	1997
Frederico Pinheiro Fleury Curado	39	Executive Vice-President—Commercial Airline Market	1997
Romualdo Monteiro de Barros	52	Executive Vice-President—Commercial Defense Market	1997
Horácio Aragonés Forjaz	49	Executive Vice-President—Planning and Organizational Development	1998
Carlos Rocha Villela	45	Executive Vice-President—Legal Counsel	1999

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

Antonio Luiz Pizarro Manso. Prior to becoming Executive Corporate Vice-President of Embraer in 2001, Mr. Manso was Embraer's chief financial officer from 1995 to 2001. 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—Industrial 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—Commercial Airline Market 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—Commercial 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—Planning and Organizational Development of Embraer in 1998, Mr. Forjaz was Embraer's engineering officer. Prior to that, he was the operational director of Compsis—Computadores e Sistemas Ltda., a systems engineering and software company, from 1995 to 1997. 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 Executive Vice-President—Legal 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.

Audit Committee

Under the Brazilian corporation law, the *conselho fiscal* (audit committee) is a corporate body independent of management and a company's external auditors. A Brazilian audit committee is not equivalent to, or comparable with, a U.S. audit committee. The primary responsibility of the audit committee is to review management's activities and the financial statements, and report its findings to the shareholders. Under the Brazilian corporation law, the audit committee 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 corporation law requires the audit committee members to receive as remuneration at least 10% of the average amount paid to each executive officer. The Brazilian corporation law requires an audit committee to be composed of a minimum of three and a maximum of five members and their respective alternates.

We have a permanent audit committee whose members are elected at the annual shareholders meeting, with terms lasting until the next annual shareholders' meeting after their election. Under the Brazilian corporation law, holders of preferred shares have the right to elect separately one member of the audit committee. Also, under the Brazilian corporation law, minority groups of shareholders which hold at least 10% of the voting shares also have the right to elect separately one member of the audit committee. In any event, however, the common shareholders have the right to elect the majority of the members of the audit committee. Set forth below are the names and positions of the members of our audit committee and their respective alternates at April 30, 2001.

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
Nelson João Aiex	Effective member	1996
José Mauro Laxe Vilela	Alternate	1999
João Maria Stefanon	Effective member	2000
Ivan Mendez do Carmo	Alternate	2000
Paulo Euclides Bonzanini	Effective member	2000
José Edson da Silva	Alternate	1999

Auditors

Our independent public accountants, or auditors, are Arthur Andersen S/C, and they have audited our consolidated financial statements as of December 31, 1998, 1999 and 2000 and the related consolidated statements of income, cash flow and changes in shareholders' equity for the years then ended that are included in this prospectus. Arthur Andersen S/C is located at Rua Alexandre Dumas, 1981, 04717-906 São Paulo, SP, Brazil. They are members of the *Conselho Regional de Contabilidade* (Regional Board of Accountants of São Paulo) and their registration number is CRC2SP000123/O-1.

Compensation

According to our bylaws, our shareholders are responsible for establishing the aggregate compensation we pay to the members of our board of directors and the executive officers. The members of our board of directors are then responsible for distributing such aggregate compensation individually in compliance with our bylaws. There are no provisions in our bylaws regarding our directors' power, in the absence of an independent quorum, to grant compensation to themselves.

For the fiscal year ended December 31, 2000, 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 R$12.7 million. In addition, in 2000 the executive officers received pension benefits, instituted in January 1999, of approximately R$170,934 in constant *reais* as of December 31, 2000. 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 June 11, 2001, the board members and executive officers owned an aggregate of 19 common shares and no preferred shares. As of June 11, 2001, our executive officers also owned options to purchase an aggregate of 7,050,000 preferred shares at per-share purchase prices ranging from R$.75 to R$23.00. Of these options, 3,600,000 were exercisable beginning in May 2001 and expire on or before May 2008. At March 31, 2001, none of the board members and executive officers had any financial or other interests in any transaction involving Embraer which was not in the ordinary course of our business.

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

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 are authorized to grant options to purchase up to 25,000,000 preferred shares. 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. At June 11, 2001, options to purchase an aggregate of 19,950,000 preferred shares had been granted at a weighted average exercise price of R$6.01 per preferred share, of which 4,515,000 were exercisable beginning in May 2001. Of this amount, options to purchase an aggregate of 7,050,000 preferred shares had been granted to our executive officers, at a weighted average exercise price of R$4.93 per preferred share, of which 3,600,000 were exercisable beginning in May 2001 and which expire on various dates ending in May 2008.

In the event that additional options are granted under the plan, the price of the preferred shares will be equal to the weighted average price of the preferred shares traded on the São Paulo Stock Exchange in the 60 trading days prior to the granting date, increased or decreased by up to 30%, as defined by a committee appointed by our board of directors. Such percentage is deemed to offset unusual fluctuations in the market price. The plan will be terminated five years after the first granting of options thereunder.

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.

In addition, although we recorded net losses for 1996 and 1997, and there was no plan in those years, in consideration of our reduction in costs and improving financial conditions during those two years, R$4.7 million was distributed to our employees in February 1997 in connection with the 1996 fiscal year, and R$1.6 million was distributed to employees in February 1998 in connection with the 1997 fiscal year. For the 1998 fiscal year, the first year that we operated profitably since the adoption of our profit sharing plan, we distributed R$22.2 million to employees. For the 1999 fiscal year, we distributed R$42.2 million to employees, and for the 2000 fiscal year, we distributed R$81.7 million to employees.

PRINCIPAL AND SELLING SHAREHOLDERS

Principal Shareholders

We have total authorized capital of 900,000,000 shares, with a total aggregate of 617,347,874 shares issued and outstanding at June 11, 2001. Of this total, 242,544,448 are common shares (including one special "golden share" held by the Brazilian government) and 374,803,426 are non-voting preferred shares. The following table includes an additional 4,515,000 preferred shares issuable upon exercise of outstanding stock options that were exercisable beginning in May 2001. 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 officers and directors as a group at June 11, 2001, including preferred shares underlying options and warrants exercisable within 60 days of the date of this prospectus.

	Common Shares		Preferred shares beneficially owned prior to offerings		Preferred shares offered in the offerings	Preferred shares beneficially owned after the offerings	
	Shares	(%)	Shares	(%)	Shares	Shares	(%)
PREVI*	57,594,479	23.8	59,356,935	15.8	11,500,001	47,856,934	12.8
SISTEL*	48,508,890	20.0	40,157,904	10.7	18,523,865	21,634,039	5.8
Cia. Bozano*	48,509,220	20.0	16,609,300	4.4	139,325	16,469,975	4.4
Bozano Holdings Ltd.*(1)	—	—	42,080,924	11.2	18,379,536	23,701,388	6.3
BNDESPAR*(1)	—	—	73,938,000	19.7	18,518,859	55,419,141	14.8
Dassault Aviation(2)	13,744,186	5.7	—	—	—	—	—
Thales™(2)	13,744,186	5.7	—	—	—	—	—
EADS(2)	13,744,186	5.7	—	—	—	—	—
SNECMA(2)	7,276,332	3.0	—	—	—	—	—
BB Banco de Investimento, S.A.(3)	3,015,562	1.2	2,156,000	**	—	2,156,000	**
União Federal/Brazilian Government(4)	3,514,388	1.5	—	—	—	—	—
Officers and directors as a group(5)	19	**	3,600,000	**	—	3,600,000	**
Other(6)	32,893,000	13.6	141,419,363	37.6	—	208,480,949	55.5
Total	242,544,448		379,318,426		67,061,586	379,318,426	
Percentage of total shares outstanding		39.0		61.0			

* Selling shareholder.

** Less than 1%.

(1) The above table does not reflect the purchase by Bozano Holdings Ltd. of US$34,500,000 principal amount of exchangeable notes from the initial purchasers in the concurrent private offering of such notes by BNDES. If all of the exchangeable notes issued in the concurrent private offering by BNDES (including notes issued pursuant to the exercise of an over-allotment option) were exchanged for ADSs, BNDESPAR's holdings of our preferred shares would be reduced by 25,494,000 preferred shares and Bozano Holdings Ltd.'s holdings would be increased by 2,931,810 preferred shares. These notes will be exchangeable at any time prior to their maturity at the option of the holders.

(2) Member of the European Aerospace and Defense Group.

(3) BB Banco de Investimento, S.A. is an affiliate of the Brazilian government-owned Banco do Brasil S.A.

(4) The Brazilian government also holds the "golden share." See "Description of Capital Stock—Golden Share."

(5) The number of preferred shares beneficially owned by our officers and directors as a group consists solely of preferred shares underlying options that were exercisable beginning in May 2001, out of a total of 19,950,000 preferred shares underlying all outstanding options.

(6) The number of preferred shares includes 915,000 preferred shares underlying options that were exercisable beginning in May 2001, out of a total of 19,950,000 preferred shares underlying all outstanding options.

The selling shareholders will hold the same number of common shares following the offerings because only preferred shares are being offered in the offerings. Other than as discussed under "Business—History" there have been no significant changes in percentage ownership by any major shareholder in the past three years.

Cia. Bozano and Bozano Holdings Ltd. are wholly owned, directly, by Julio Bozano, a Brazilian national. See "—Selling Shareholders."

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, two representatives (and alternates) of the European Aerospace and Defense Group and one other representative (and alternate) of the Brazilian government, in addition to the representative (and alternate) of the Brazilian government, as holder of the "golden share," and two representatives (and alternates) of our employees.

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.

The Brazilian Government

At June 11, 2001, the Brazilian government directly held 1.5% of our common shares, and held 1.2% of our common shares and less than 1% of our preferred shares through BB Banco de Investimento, S.A., an affiliate of the Brazilian government-owned Banco do Brasil S.A. On that date, the Brazilian government held 1.4% of our total shares, including the shares held by BB Banco de Investimento, S.A. The Brazilian government's common shares include one special common share, known as the "golden share," which carries veto power over major corporate actions. See "Description of Capital Stock—Golden Share." Currently, two members of our board of directors are representatives of the Brazilian government. The Brazilian government has the right to designate one board member. The second representative has been elected by our controlling shareholders pursuant to the shareholders' agreement.

The European Aerospace and Defense Group

At June 11, 2001, the European Aerospace and Defense Group owned 20.0% of our common shares, which corresponds to 7.9% of our total shares. Under the shareholders' agreement, our controlling shareholders have agreed to appoint two representatives of the European Aerospace and Defense Group to our board of directors when they select their members of our board. See "—Principal Shareholders" for more information on the shareholders' agreement. The European Aerospace and Defense Group acquired these shares from our existing common shareholders, a majority of which was from our controlling shareholders, in November 1999. For more information about the European Aerospace and Defense Group, see "Business—Strategic Alliance with European Aerospace and Defense Group."

Selling Shareholders

The following table sets forth, as of June 11, 2001, with respect to each selling shareholder, the amount and percentage of class of preferred shares owned prior to the offerings, the amount of preferred shares to be offered in the offerings and the amount and percentage of the class of preferred shares owned after completion of the offerings. Except for these offerings and in connection with the concurrent private offering of exchangeable notes by BNDESPAR, the selling shareholders have agreed not to sell or otherwise dispose of any shares of Embraer without the consent of Morgan Stanley & Co. Incorporated for a period of 90 days after the date of this prospectus.

	Preferred shares beneficially owned prior to offerings		Preferred shares offered in the offerings	Preferred shares beneficially owned after the offerings	
	Shares	(%)	Shares	Shares	(%)
PREVI	59,356,935	15.8	11,500,001	47,856,934	12.8
SISTEL	40,157,904	10.7	18,523,865	21,634,039	5.8
Cia. Bozano	16,609,300	4.4	139,325	16,469,975	4.4
Bozano Holdings Ltd.(1)	42,080,924	11.2	18,379,536	23,701,388	6.3
BNDESPAR(1)	73,938,000	19.7	18,518,859	55,419,141	14.8
Total	232,143,063		67,061,586	165,081,477	

(1) The above table does not reflect the purchase by Bozano Holdings Ltd. of US$34,500,000 principal amount of exchangeable notes in the concurrent private offering of such notes by BNDES. If all of the exchangeable notes issued in the concurrent private offering by BNDES (including notes issued pursuant to the exercise of an over-allotment option) were exchanged for ADSs, BNDESPAR's holdings of our preferred shares would be reduced by 25,494,000 preferred shares and Bozano Holdings Ltd.'s holdings would be increased by 2,931,810 preferred shares. These notes will be exchangeable at any time prior to their maturity at the option of the holders.

Bozano Holdings Ltd.

At June 11, 2001, Bozano Holdings Ltd., a company organized under the laws of the Cayman Islands, owned 11.2% of our preferred shares, which corresponds to 6.8% of our total shares. Bozano Holdings Ltd. is a diversified foreign investment holding company holding interests inside and outside of Brazil. Bozano Holdings Ltd. is owned and controlled by Julio Bozano. The registered offices of Bozano Holdings Ltd. are located at CITCO Trustees (Cayman) Limited, Corporate Centre, West Bay Road, P.O. Box 31106, SMB, Grand Cayman, Cayman Islands. Bozano Holdings Ltd. intends to sell in the international offering 18,379,536 preferred shares for its own account.

Caixa de Previdência dos Funcionários do Banco do Brasil—PREVI

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. PREVI is the largest private social security entity in Brazil. At June 11, 2001, PREVI owned 23.8% of our common shares, 15.8% of our preferred shares, which corresponds to 18.9% of our total shares. PREVI intends to sell in the international and Brazilian offerings 11,500,001 preferred shares for its own account. The Brazilian government controls Banco do Brasil S.A. The principal executive offices of PREVI are located at Praia de Botafogo, 501, 4th floor, 22250-040 Rio de Janeiro, RJ, Brazil.

Fundação SISTEL de Seguridade Social

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. SISTEL is the second-largest private social security entity in Brazil. At June 11, 2001, SISTEL owned, directly and through two investment funds owned by it, 20.0% of our common shares, 10.7% of our preferred shares, which corresponds to 14.4% of our total shares. SISTEL intends to sell in the international and Brazilian offerings 18,523,865 preferred shares for its own account. The principal executive offices of SISTEL are located at SEP Sul 702/902, Ed. General Alencastro, 70390-025 Brasília, DF, Brazil.

BNDES Participações S.A.—BNDESPAR

BNDESPAR, a wholly owned subsidiary of Banco Nacional de Desenvolvimento Econômico e Social—BNDES, the government-owned national development bank of Brazil, is one of Brazil's principal sources of equity investment in private sector enterprises. BNDESPAR primarily makes temporary, minority investments in Brazilian companies. At June 11, 2001, BNDESPAR owned 19.7% of our preferred shares, which corresponds to 12.0% of our total shares. BNDESPAR intends to sell in the international and Brazilian offerings 18,518,859 preferred shares for its own account. The principal executive offices of BNDESPAR are located at Av. República do Chile, 100, 19th floor, 20139-900 Rio de Janeiro, RJ, Brazil.

Cia. Bozano

At June 11, 2001, Cia. Bozano, a company organized under the laws of Brazil, owned 20.0% of our common shares and 4.4% of our preferred shares, which corresponds to 10.6% of our total shares. Cia. Bozano is a diversified Brazilian investment holding company. Cia. Bozano is owned and controlled by Julio Bozano. Cia. Bozano is affiliated with Bozano Holdings Ltd. The principal executive offices of Cia. Bozano are located at Rua Visconde de Ouro Preto, 5, 10th floor, 22250-180 Rio de Janeiro, RJ, Brazil. Cia. Bozano intends to sell in the Brazilian offering 139,325 preferred shares for its own account.

TRANSACTIONS WITH RELATED PARTIES

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. In 1994, approximately 51.7% of our net sales related to defense products, of which 76.6% have represented sales to the Brazilian government. For the years ended December 31, 1998, 1999 and 2000 and the three months ended March 31, 2001, the Brazilian government accounted for approximately 9.3%, 5.8%, 2.4% and 1.9% of our net sales. 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 ''Business—Defense Business.''

The Brazilian government plays a key role as:

- a source for funded research and development through technology development institutions such as FINEP and the BNDES; and
- an export support agency through the BNDES.

See ''Business—Aircraft Financing Arrangements,'' ''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 ''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 to fund general capital expenditures associated principally with the ERJ 145, including research and development, of which R$118.3 million principal amount was outstanding at March 31, 2001. Amounts borrowed from BNDES are secured by equipment, machinery and four ERJ 145 training aircraft. The interest rate on amounts borrowed from BNDES range from TJLP plus 3% to TLJP plus 5.5% per annum. We also pay fees to BNDES at the rate of .35% of the sales price of each ERJ 145 that we sell, limited to 420 aircraft sold between January 1, 1997 and December 3, 2005. See ''Management's Discussion and Analysis of Financial Conditions and Results of Operations—Liquidity and Capital Resources—Credit Facilities and Lines of Credit'' and note 13.d to our audited financial statements for a further discussion of our credit facilities with BNDES. In addition, we maintain a credit facility with FINEP to fund a portion of our development cost of the AL-X, of which R$24.5 million principal amount was outstanding at March 31, 2001 at an annual interest rate of TJLP plus 4%.

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 the concurrent private offering of exchangeable notes by BNDES, we expect to be party to a registration rights agreement pursuant to which we will agree, among other things, to register resales of the ADSs and underlying preferred shares relating to the exchangeable notes. We expect to agree 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 10 preferred shares or, under some limited circumstances, 10 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$2.4228 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$2.4928 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. Except for the international and Brazilian offerings and in connection with the concurrent private offering of exchangeable notes, BNDESPAR has agreed not to sell or otherwise dispose of any shares of Embraer without the consent of Morgan Stanley & Co. Incorporated for a period of 90 days after the date of this prospectus.

BB Banco de Investimento, S.A. is an affiliate of the Brazilian government-owned Banco do Brasil S.A., with which we have entered into numerous financing transactions from time to time in the past. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Credit Facilities and Lines of Credit" for a discussion of these financing transactions. BB Banco de Investimento, S.A. is an underwriter in the Brazilian offering.

European Aerospace and Defense Group

We believe that our alliance with the European Aerospace and Defense Group will help us to increase our technological capabilities and to market innovative defense products. This alliance will also allow us to substantially grow our business in the future through access to a broader customer base for our regional aircraft and introduction of aircraft asset management services. As a result, we may enter into a number of transactions with members of the European Aerospace and Defense Group to accomplish these goals.

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 ERJ 170/190 regional 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 ERJ 170/190 regional jet family and for each component of the system to be supplied by GECAT to provide training for our customers for the ERJ 170/190 regional jet family, which system includes flight simulators, courseware, training media, computer-based training, and training courses.

We have executed a memorandum of intentions with Dassault and Thales™ under which we have agreed to negotiate and enter into a consortium agreement related to the development of defense aircraft for the Brazilian government. We, Dassault and Thales™ have also agreed not to, either directly or indirectly, enter into negotiations with any person or entity regarding a competing transaction. We cannot assure you that any negotiations with Dassault and Thales™ will lead to the execution of any consortium agreement.

DESCRIPTION OF CAPITAL STOCK

Set forth below is material information concerning our preferred shares and common shares, with a brief summary of significant provisions of our bylaws and the Brazilian corporation law. This description is qualified by reference to our bylaws and to Brazilian law. Information on the trading market for the preferred shares is set forth under "Market Information," and information on ownership of our shares is set forth under "Principal and Selling Shareholders."

General

At November 30, 1997, our monetarily restated paid-in capital was R$2,943.5 million. Our capital stock at such date consisted of a total of 48,449,323,942 outstanding shares, without par value, of which 24,254,444,769 were common shares, including one special class of common shares known as the "golden share," held by the Brazilian government, 23,867,342,666 were Class A preferred shares, and 327,536,507 were Class B preferred shares. On December 12, 1997, we reduced our monetarily restated paid-in capital from R$2,943.5 million to R$713.8 million, due to accumulated losses, without affecting the number of our outstanding shares.

Further, on May 11, 1999, we redeemed all outstanding Class B preferred shares for an aggregate of R$24.5 million. On April 30, 1999, our shareholders approved a reverse stock split in which 100 preferred shares or 100 shares of common stock were exchanged for one new preferred share or common share. The golden share was not affected by this reverse stock split. On February 18, 2000, 8,335,000 preferred shares were issued as a result of the exercise of 833,500 subscription warrants, with a consequent increase of our monetarily restated paid-in capital by R$14.1 million. See "—Debentures and Subscription Warrants."

On July 26, 2000, our monetarily restated paid-in capital was increased from R$727.9 million to R$1,203.2 million, with the issuance of 52,800,000 preferred shares, without par value, for sale in our global equity offering. See "Business—History." On July 27, 2000, our monetarily restated paid-in capital was increased to R$1,205.1 million, with the issuance of 1,057,000 preferred shares, as a result of the exercise of 105,700 subscription warrants by BNDESPAR.

At March 31, 2001, our monetarily restated paid-in capital was R$1,205.1 million. At June 11, 2001, our capital stock consisted of a total of 617,347,874 outstanding shares, without par value, of which 242,544,448 were common shares, including one special common share known as the "golden share," held by the Brazilian government, and 374,803,426 were preferred shares. Our bylaws authorize the board of directors to increase the capital stock up to 300,000,000 common shares and up to 600,000,000 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 corporation 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 corporation 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 corporation 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 "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 corporation law, preferred shares, including the preferred shares offered by this prospectus, not entitled to fixed or minimum dividend payments, are entitled to receive dividends in an amount per share that is 10% greater than the amount per share payable on our common shares. See "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 carries veto power over the following corporate actions:

- change of corporate purpose;
- change of our name;
- alteration and use of our logo;
- creation or alteration of defense programs (whether the Brazilian government participates or not in such programs);
- acceptance, for defense programs, of the technological qualifications of third parties;
- interruptions in the supply of maintenance and spare parts for defense aircraft;
- change of 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 attributed 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 corporation 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 "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.

Regulation of Foreign Investment

There are no restrictions on ownership of 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 Brazilian Securities Commission 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.

Following the closing of this offering, an amendment to the existing electronic registration will be made in the name of the depositary with respect to the ADSs sold in the international offering and will be maintained by the Brazilian custodian for the preferred shares on behalf of the depositary. This electronic registration is carried on through the Central Bank Information System-SISBACEN. Pursuant to the registration, the custodian and the depositary will be 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, unless the preferred shares are held pursuant to Resolution No. 2,689, by a duly registered investor, or, if not a registered investor under Resolution No. 2,689, a holder of preferred shares applies for and obtains a new certificate of registration, the 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, and the holder, if not registered under Resolution No. 2,689, will be subject to less favorable Brazilian tax treatment than a holder of ADSs. In addition, if the foreign investor resides in a "tax haven" jurisdiction, the investor will be also subject to less favorable tax treatment.

See "Risk Factors—Risks Relating to the Preferred Shares and the ADSs—If you exchange the ADSs for preferred shares, you risk losing the ability to remit foreign currency abroad and Brazilian tax advantages" and "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 corporation law and our bylaws, the board of directors may, in its discretion, eliminate the preemptive rights of the shareholders in the issuance of shares, debentures convertible into shares, and subscription warrants that will be offered either in 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, you may not be able to exercise the preemptive rights relating to the preferred shares underlying your 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. See ''Risk Factors—Risks Relating to the Preferred Shares and the ADSs—You might be unable to exercise preemptive rights with respect to the preferred shares'' and ''Description of American Depositary Shares.''

Redemption and Right of Withdrawal

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

The Brazilian corporation 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 corporation 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 corporation law; or
- to participate in a centralized group of companies as defined under the Brazilian corporation law and subject to the conditions set forth therein.

The right of withdrawal lapses 30 days after publication of the minutes of the relevant shareholders' meeting unless, in the first two bullet points above, the resolution is subject to the prior approval or subsequent ratification by holders of a majority of the outstanding preferred shares (which must be made at a special meeting to be held within one year), in which case 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.

This right of withdrawal may also be exercised in the event that the entity resulting from a merger, *incorporação de ações*, as described above, consolidation or 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.

Law No. 9,457 dated May 5, 1997, which amended the Brazilian corporation law, contains provisions that, among others, restrict withdrawal rights and allow companies to redeem their shares at their economic value. 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.

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 corporation 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.

Debentures and Subscription Warrants

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 10 preferred shares or, under some limited circumstances, 10 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$2.4228 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$2.4928 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. Except for the international and Brazilian offerings and in connection with the concurrent private offering of exchangeable notes, BNDESPAR has agreed not to sell or otherwise dispose of any shares of Embraer without the consent of Morgan Stanley & Co. Incorporated for a period of 90 days after the date of this prospectus.

Proposed Changes to the Brazilian Corporation Law

A bill to modify the Brazilian corporation law is currently pending. If passed in its current form, the bill would enact the following changes to the Brazilian corporation law and require that we adapt our bylaws to the provisions of the new law within one year after the bill becomes effective:

- Preferred shares representing 10% of the outstanding shares not held by the controlling shareholders would be entitled to a representative on our board of directors;
- Preferred shareholders together with common shareholders (excluding the controlling shareholders) would be entitled to a representative on our audit committee;
- Disputes among our shareholders would be subject to arbitration if provided for in our bylaws;
- Shareholders representing 10% of our outstanding shares would be entitled to convene a shareholders' meeting to deliberate with respect to any conflict of interest of management;
- A tender offer at a purchase price equal to fair value for all outstanding shares would be required upon a delisting or a substantial reduction in liquidity of our shares as a result of purchases by the controlling shareholders;
- Any sale of control would require us to tender for the minority shareholders' common shares, and, if provided for in our bylaws, for the minority shareholders preferred shares, at a purchase price at least equal to 80% of the price per share paid to the controlling shareholder;
- Shareholders would be entitled to withdraw from us upon a spin-off only if it entailed a change in the corporate purpose, a reduction in mandatory dividends or the participation in a centralized group of companies;
- Our controlling shareholders, the shareholders that elect members to our board of directors and audit committee, the members of our board of directors and audit committee and our executive officers would be required to disclose any purchase or sale of our shares to the Brazilian Securities Commission and the São Paulo Stock Exchange;
- Our executive officers and two-thirds of the members of our board of directors would have to reside in Brazil; and
- We would be permitted to satisfy our information disclosure requirements through the Internet.

We cannot predict whether the bill will be enacted into law as currently proposed or in any other form.

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 corporation 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 corporation 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 March 31, 2001, the balance of our legal reserve was R$67.5 million, which was equal to 5.6% of our monetarily restated paid-in capital at March 31, 2001.

The Brazilian corporation 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 corporation 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 corporate law method.

Mandatory Distribution

The Brazilian corporation 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 the preferred shares offered by this prospectus, 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 corporation 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 Brazilian Securities Commission. 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 corporation 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 corporation 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 as described under ''—Additional Payments on Shareholders' Equity'') in respect of its shares, after which the amount of the unclaimed dividends reverts to us.

The Brazilian corporation 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 had 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 the 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 will electronically register the preferred shares underlying the ADSs with the Central Bank and, therefore, will be able to have dividends, sales proceeds or other amounts with respect to these shares eligible to be remitted outside Brazil. See ''Description of Capital Stock—Regulation of Foreign Investment.''

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. See ''Description of Capital Stock—Regulation of Foreign Investment'' and ''Description of American Depositary Shares.'' 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 ''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 ''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, as well as the percentage each one of the payments represents of our net income in the mentioned periods.

Date of approval	Period in which profits were generated	Total amount of distribution	Percentage of net income	Base period for calculation of percentage
September 18, 1998(1)	First two quarters of 1998	R$ 21.3 million	16.1	Year ended December 31, 1998
March 30, 1999(1)	Remaining two quarters of 1998	R$ 33.9 million	25.7	Year ended December 31, 1998
September 28, 1999(1)	First two quarters of 1999	R$ 36.8 million	8.9	Year ended December 31, 1999
January 31, 2000(1)	Remaining two quarters of 1999	R$ 86.7 million	21.0	Year ended December 31, 1999
March 24, 2000(2)	First quarter of 2000	R$ 16.7 million	16.5	Three months ended March 31, 2000
June 16, 2000(2)	Second quarter of 2000	R$ 16.9 million	13.6	Three months ended June 30, 2000
July 6, 2000(1)	First two quarters of 2000	R$ 79.6 million	12.3	Year ended December 31, 2000
September 22, 2000(2)	Third quarter of 2000	R$ 23.5 million	12.5	Three months ended September 30, 2000
December 15, 2000(2)	Fourth quarter of 2000	R$ 28.5 million	11.3	Three months ended December 31, 2000
March 16, 2001(1)	Remaining two quarters of 2000	R$107.5 million	16.7	Year ended December 31, 2000
March 16, 2001(2)	First quarter of 2001	R$ 28.8 million	12.8	Three months ended March 31, 2001

(1) Represents dividend payments.

(2) Represents interest on shareholders' equity.

We intend to declare and pay dividends and/or interest on shareholders' equity, as required by the Brazilian corporation 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.

DESCRIPTION OF AMERICAN DEPOSITARY SHARES

American Depositary Receipts

Morgan Guaranty Trust Company of New York, as depositary, will issue the ADSs which you will be entitled to receive in the international offering. Each ADS will represent an ownership interest in four preferred shares. We will deposit the preferred shares with the custodian, Banco Itaú S.A., as agent of the depositary, under the deposit agreement among ourselves, the depositary and yourself as an ADR holder. In the future, each ADS will also represent any securities, cash or other property deposited with the depositary but not distributed by it directly to you. Your ADSs will be evidenced by what are known as American depositary receipts or ADRs.

The depositary's principal executive office is located at 60 Wall Street, New York, New York 10260.

You may hold ADSs either directly or indirectly through your broker or other financial institution. If you hold ADSs directly, by having an ADS registered in your name on the books of the depositary, you are an ADR holder. This description assumes you hold your ADSs directly. If you hold the ADSs through your broker or financial institution's nominee, you must rely on the procedures of such broker or financial institution to assert the rights of an ADR holder described in this section. You should consult with your broker or financial institution to find out what those procedures are.

Because the depositary's nominee will actually be the registered owner of the preferred shares, you must rely on it to exercise the rights of a shareholder on your behalf. The obligations of the depositary and its agents are set out in the deposit agreement. The deposit agreement and the ADSs are governed by New York law.

The following is a summary of the material terms of the deposit agreement. Because it is a summary, it does not contain all the information that may be important to you. For more complete information, you should read the entire deposit agreement and the form of ADR, which contains the terms of your ADSs. You can read a copy of the deposit agreement, which is filed as an exhibit to the registration statement of which this prospectus forms a part. You may also obtain a copy of the deposit agreement at the Securities and Exchange Commission's Public Reference Room, which is located at 450 Fifth Street, N.W., Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the Commission at 1-800-732-0330.

Share Dividends and Other Distributions

How will I receive dividends and other distributions on the preferred shares underlying my ADSs?

We may make various types of distributions with respect to our securities. The depositary has agreed to pay to you the cash dividends or other distributions it or the custodian receives on preferred shares or other deposited securities, after deducting its expenses. You will receive these distributions in proportion to the number of underlying preferred shares your ADSs represent.

Except as stated below, to the extent that the depositary is legally permitted, it will deliver such distributions to ADR holders in proportion to their interests in the following manner:

- *Cash.* The depositary will convert cash distributions from foreign currency to U.S. dollars if this is permissible and can be done on a reasonable basis. The depositary will endeavor to distribute such cash in a practicable manner, and may deduct any taxes required to be withheld, any expenses of converting foreign currency and transferring funds to the United States, and other expenses and adjustments. If this conversion is not possible or if any approval from the Brazilian government is needed and cannot be obtained, the deposit agreement allows the depositary to distribute *reais* only to those ADR holders to whom it is possible to do so. It will hold the *reais* it cannot convert for the account of the ADR holders who have not been paid. It will not invest the *reais* on behalf of the ADR holders and it will not be liable for the interest.

- Before making a distribution, any withholding taxes that must be paid under Brazilian law will be deducted. See ''Taxation—Brazilian Tax Consequences—Taxation of Dividends.'' The depositary will distribute only whole U.S. dollars and cents and will round fractional cents to the nearest whole cent. *If the exchange rates fluctuate during a time when the depositary cannot convert Brazil's currency, you may lose some or all of the value of the distribution.*

- *Preferred shares.* In the case of a distribution in preferred shares, the depositary will issue additional ADRs to evidence the number of ADSs representing such shares. Only whole ADSs will be issued. Any preferred shares which would result in fractional ADSs will be sold and the net proceeds will be distributed to the ADR holders entitled thereto.

- *Rights to receive additional preferred shares.* In the case of a distribution of rights to subscribe for additional preferred shares or other rights, if we provide satisfactory evidence that the depositary may lawfully distribute such rights, the depositary may arrange for ADR holders to instruct the depositary as to the exercise of such rights. However, if we do not furnish such evidence or if the depositary determines that it is not practical to distribute such rights, the depositary may:

  - sell such rights if practicable and distribute the net proceeds as cash; or

  - allow such rights to lapse, in which case ADR holders will receive nothing.

  We have no obligation to file a registration statement under the Securities Act in order to make any rights available to ADR holders.

- *Other distributions.* In the case of a distribution of securities or property other than those described above, the depositary may either:

  - distribute such securities or property in any manner it deems fair and equitable;

  - sell such securities or property and distribute any net proceeds in the same way that it distributes cash; or

  - hold the distributed property, in which case the ADSs will also represent the distributed property.

Any U.S. dollars will be distributed by checks drawn on a bank in the United States for whole dollars and cents (fractional cents will be withheld without liability for interest and added to future cash distributions).

The depositary may choose any practical method of distribution for any specific ADR holder, including the distribution of foreign currency, securities or property, or it may retain such items on behalf of the ADR holder as deposited securities, without paying interest on or investing them.

The depositary is not responsible if it decides that it is unlawful or impractical to make a distribution available to any ADR holder.

We cannot assure you that the depositary will be able to convert any currency at a specified exchange rate or sell any property, rights, shares or other securities at a specified price, or that any of such transactions can be completed within a specified time period.

Deposit, Withdrawal and Cancellation

How does the depositary issue ADSs?

The depositary will issue ADSs if you or your broker deposits preferred shares or evidence of rights to receive preferred shares with the custodian. In the case of the ADSs offered by this prospectus, we will arrange with the underwriters named herein to deposit such preferred shares.

Preferred shares deposited in the future with the custodian must be accompanied by documents which show that the preferred shares have been properly transferred or endorsed to the person on whose behalf the deposit is being made.

The custodian will hold all deposited shares (including those being deposited by or on our behalf in connection with the international offering to which this prospectus relates) for the account of the depositary. ADR holders thus have no direct ownership interest in the preferred shares and only have such rights as are contained in the deposit agreement. The custodian will also hold any additional securities, property and cash received on or in substitution for the deposited shares. The deposited shares and any such additional items are referred to as ''deposited securities.''

Upon each deposit of preferred shares, receipt of related delivery documentation and compliance with the other provisions of the deposit agreement, including the payment of the fees and charges of the depositary and any taxes or other fees or charges owing, the depositary will issue an ADR or ADRs in the name of the person entitled thereto evidencing the number of ADSs to which such person is entitled. Certificated ADRs will be delivered at the depositary's principal New York office or any other location that it may designate as its transfer office.

How do ADR holders cancel an ADS and obtain deposited securities?

When you turn in your ADS at the depositary's office, the depositary will, upon payment of applicable fees, charges and taxes, and upon receipt of proper instructions, deliver the underlying shares to you at the custodian's office. At your risk, expense and request, the depositary may deliver such shares to you at such other place as you may request.

The depositary may only restrict the withdrawal of deposited securities in connection with:

- temporary delays caused by closing our transfer books or those of the depositary, or the deposit of preferred shares in connection with voting at a shareholders' meeting, or the payment of dividends;
- the payment of fees, taxes and similar charges; or
- compliance with any U.S. or foreign laws or governmental regulations relating to the ADRs.

This right of withdrawal may not be limited by any other provision of the deposit agreement.

Voting Right

How do I vote?

As described in ''Description of Capital Stock—Voting Rights of the Preferred Shares,'' preferred shares do not entitle the holder to vote, except under limited circumstances explained therein. Therefore, in cases of meetings of holders of preferred shares or other deposited securities and if you are an ADR holder and the depositary asks you to provide it with voting instructions, you may instruct the depositary as to how to exercise the voting rights for the preferred shares which underlie your ADSs. After receiving voting materials from us, the depositary will notify the ADR holders of any shareholders' meeting or solicitation of consents or proxies. This notice will describe how you may instruct the depositary to exercise the voting rights for the preferred shares which underlie your ADSs. For instructions to be valid, the depositary must receive them on or before the date specified. The depositary will try, as far as is practical, subject to the provisions of the deposit agreement and the law governing the underlying preferred shares or other deposited securities, to vote or to have its agents vote the preferred shares or other deposited securities as you instruct. The depositary will only vote or attempt to vote as you instruct. The depositary will not itself exercise any voting discretion. Neither the depositary nor its agents are responsible for any failure to carry out any voting instructions, for the manner in which any vote is cast or for the effect of any vote.

There is no guarantee that you will receive voting materials in time to instruct the depositary to vote, and it is possible that you, or persons who hold their ADSs through brokers, dealers or other third parties, will not have the opportunity to exercise a right to vote.

Record Dates

The depositary may fix record dates for the determination of the ADR holders who will be entitled:

- to receive a dividend, distribution or rights; or
- to give instructions for the exercise of voting rights at a meeting of holders of preferred shares or other deposited securities;

all subject to the provisions of the deposit agreement.

Reports and Other Communications

Will I be able to view reports from Embraer?

The depositary will make available for inspection by ADR holders any written communications from Embraer which are both received by the custodian or its nominee as a holder of deposited securities and made generally available to the holders of deposited securities. These communications will be furnished by us in English when so required by any rules or regulations of the Commission.

Books of Depositary

The depositary or its agent will maintain a register for the registration, registration of transfer, combination and split-up of ADRs. You may inspect such records at the depositary's office during regular business hours but solely for the purpose of communicating with other holders in the interest of business matters relating to the deposit agreement.

The depositary will maintain facilities to record and process the issuance, cancellation, combination, split-up and transfer of ADRs. These facilities may be closed from time to time, to the extent not prohibited by law.

Fees and Expenses

What fees and expenses will I be responsible for paying?

Except in connection with the issuance of ADSs in the international offering, ADR holders will be charged a fee for each issuance of ADSs, including issuances resulting from distributions of preferred shares, rights and other property, and for each surrender of ADSs in exchange for deposited securities. The fee in each case to be paid to the depositary is US$5.00 for each 100 ADSs (or any portion thereof) issued or surrendered. ADR holders or persons depositing preferred shares may also be charged the following expenses by the depositary:

- 0.5% of the total amount of the transfer in case of stock transfers, including other taxes and governmental charges;
- cable, telex and facsimile transmission and delivery charges based on the cost of such services;
- transfer or registration fees for the registration of transfer of deposited securities on any applicable register in connection with the deposit or withdrawal of deposited securities at the cost of such services;
- expenses of the depositary in connection with the conversion of foreign currency into U.S. dollars; and
- fees and expenses related to compliance with law, including foreign exchange control regulations or any foreign investment laws.

We will pay all other charges and expenses of the depositary and any agent of the depositary (except the custodian) pursuant to agreements from time to time between us and the depositary. The fees described above may be amended from time to time.

Payment of Taxes

ADR holders must pay any tax or other governmental charge payable by the custodian or the depositary on any ADS or ADR, deposited security or distribution. If an ADR holder owes any tax or other governmental charge, the depositary may (1) deduct the amount thereof from any cash distributions, or (2) sell deposited securities and deduct the amount owing from the net proceeds of such sale. In either case the ADR holder remains liable for any shortfall. Additionally, if any tax or governmental charge is unpaid, the depositary may also refuse to effect any registration, registration of transfer, split-up or combination of deposited securities or withdrawal of deposited securities (except under limited circumstances mandated by securities regulations). If any tax or governmental charge is required to be withheld on any non-cash distribution, the depositary may sell the distributed property or securities to pay such taxes and distribute any remaining net proceeds to the ADR holders entitled to them.

Reclassifications, Recapitalizations and Mergers

If we take actions that affect the deposited securities, including (1) any change in par value, split-up, consolidation, cancellation or other reclassification of deposited securities or (2) any recapitalization, reorganization, merger, consolidation, liquidation, receivership, bankruptcy or sale of all or substantially all of our assets, then the depositary may choose to:

- amend the form of ADR;
- distribute additional or amended ADRs;
- distribute cash, securities or other property it has received in connection with such actions;
- sell any securities or property received and distribute the proceeds as cash; or
- none of the above.

If the depositary does not choose any of the above options, any of the cash, securities or other property it receives will constitute part of the deposited securities and each ADS will then represent a proportionate interest in such property.

Amendment and Termination

How may the deposit agreement be amended?

We may agree with the depositary to amend the deposit agreement and the ADSs without your consent for any reason. ADR holders must be given at least 30 days' notice of any amendment that imposes or increases any fees or charges (except for taxes and other charges specifically payable by ADR holders under the deposit agreement), or affects any substantial existing right of ADR holders. If an ADR holder continues to hold ADRs after being so notified, such ADR holder will be considered to have agreed to such amendment. Notwithstanding the foregoing, an amendment can become effective before notice is given if this is necessary to ensure compliance with a new law, rule or regulation.

No amendment will impair your right to surrender your ADSs and receive the underlying preferred shares. If a governmental body adopts new laws or rules which require the deposit agreement or the ADS to be amended, we and the depositary may make the necessary amendments, which could take effect before you receive notice thereof.

How may the deposit agreement be terminated?

The depositary may terminate the deposit agreement by giving the ADR holders at least 60 days' prior notice, and it must do so at our request. After termination, the depositary's only responsibility will be (1) to deliver deposited securities to ADR holders who surrender their ADRs, and (2) to hold or sell distributions received on deposited securities. As soon as practicable after the expiration of one year from the termination date, the depositary will sell the deposited securities which remain and hold the net proceeds of such sales, without liability for interest, in trust for the ADR holders who have not yet surrendered their ADRs. After making such sale, the depositary shall have no obligations except to account for such proceeds and other cash. The depositary will not have to invest such proceeds or pay interest on them.

Limitations on Obligations and Liability to ADR Holders

The deposit agreement expressly limits the obligations and liability of the depositary, us and our respective agents. Neither we nor the depositary nor any such agent will be liable if it:

- is prevented or hindered in performing any obligation by circumstances beyond its control, including, without limitation, requirements of law, rule, regulation, the terms of the deposited securities, and acts of God;
- exercises or fails to exercise discretion under the deposit agreement;
- performs its obligations without gross negligence or bad faith;
- takes any action based on advice or information from legal counsel, accountants, any person presenting preferred shares for deposit, any holder, or any other qualified person; or
- relies on any documents it believes in good faith to be genuine and to have been properly executed.

Neither the depositary nor its agents have any obligation to appear in, prosecute or defend any action, suit or other proceeding in respect of any deposited securities or the ADRs. We and our agents shall only be obligated to appear in, prosecute or defend any action, suit or other proceeding in respect of any deposited securities or the ADRs, which in our opinion may involve us in expense or liability, if indemnity satisfactory to us against all expenses (including fees and disbursements of counsel) and liabilities is furnished as often as we require.

The depositary will not be responsible for failing to carry out instructions to vote the ADSs or for the manner in which the ADSs are voted or the effect of the vote.

The depositary may own and deal in deposited securities and in ADSs.

Disclosure of Interest in ADSs

We may from time to time request you and other holders and beneficial owners of ADSs to provide information as to:

- the capacity in which you and other holders and beneficial owners own or have owned ADSs;
- the identity of any other persons then or previously interested in such ADSs; and
- the nature of such interest and various other matters.

You agree to provide any information requested by us or the depositary pursuant to the deposit agreement. The depositary has agreed to use reasonable efforts to comply with written instructions received from us requesting that it forward any such requests to you and other holders and beneficial owners and to forward to us any responses to such requests to the extent permitted by applicable law.

Requirements for Depositary Actions

We, the depositary or the custodian may refuse to:

- issue, register or transfer an ADR or ADRs;
- effect a split-up or combination of ADRs;

- deliver distributions on any such ADRs; or
- permit the withdrawal of deposited securities until the following conditions have been met:
  - the holder has paid all taxes, governmental charges, and fees and expenses as required in the deposit agreement;
  - the holder has provided the depositary with any information it may deem necessary or proper, including, without limitation, proof of identity and the genuineness of any signature; and
  - the holder has complied with such regulations as the depositary may establish under the deposit agreement.

The depositary may also suspend the issuance of ADSs, the deposit of preferred shares, the registration, transfer, split-up or combination of ADRs, or the withdrawal of deposited securities, if the register for ADRs or any deposited securities is closed or if we or the depositary decides it is advisable to do so.

Pre-release of ADSs

The depositary may issue ADRs prior to the deposit with the custodian of preferred shares (or rights to receive shares). This is called a pre-release of the ADS. A pre-release is closed out as soon as the underlying preferred shares (or other ADRs) are delivered to the depositary. The depositary may pre-release ADSs only if:

- the depositary has received collateral for the full market value of the pre-released ADRs; and
- each recipient of pre-released ADRs agrees in writing that he or she:
  - owns the underlying preferred shares;
  - assigns all rights in such preferred shares to the depositary;
  - holds such preferred shares for the account of the depositary; and
  - will deliver such preferred shares to the custodian as soon as practicable, and promptly if the depositary so demands.

In general, the number of pre-released ADSs will not evidence more than 20% of all ADSs outstanding at any given time (excluding those evidenced by pre-released ADRs). However, the depositary may disregard such limit from time to time as it deems appropriate, and may, with our prior written consent, change such limit.

The Depositary

Who is the depositary?

Morgan Guaranty Trust Company of New York, a New York banking corporation, is a commercial bank offering a wide range of banking and trust services to its customers in the New York metropolitan area, throughout the United States and around the world.

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 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.

The summary is based upon the tax laws of Brazil and the United States as in effect on the date of this prospectus, which are subject to change, possibly with retroactive effect, and to differing interpretations. Prospective purchasers of preferred shares or ADSs should consult their own tax advisors as to the Brazilian, U.S. or other tax consequences of the purchase, ownership and disposition of preferred shares or ADSs, including, in particular, the effect of any foreign, state or local tax laws.

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 Brazilian Securities Commission; 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 Brazilian Securities Commission. In addition, securities trading is restricted to transactions carried out in the stock exchanges or organized over-the-counter markets licensed by the Brazilian Securities Commission.

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 retained earnings generated prior to January 1, 1996 (or reserves out of such earnings).

Taxation of Gains. For purposes of Brazilian taxation, there are two types of non-Brazilian holders of ADSs or preferred shares: (1) non-Brazilian holders that are not resident or domiciled in a tax haven jurisdiction (i.e., a country that does not impose income tax or where the maximum income tax rate is lower than 20%), and which, in the case of holders of preferred shares, are registered before the Central Bank and the Brazilian securities commission to invest in Brazil in accordance with Resolution No. 2,689; and (2) other non-Brazilian holders, which include any and all non-residents of Brazil who invest in equity securities of Brazilian companies through any other means and all types of investors that are located in tax haven jurisdictions. The investors identified on clause (1) above are subject to favorable tax treatment in Brazil, as described below.

Gains realized outside Brazil by a non-Brazilian holder on the disposition of ADSs to another non-Brazilian holder are not subject to Brazilian tax.

The deposit of preferred shares in exchange for ADSs may be subject to Brazilian capital gains at the rate of 15% if the amount previously registered with the Central Bank, as a foreign investment in the preferred shares is lower than (1) the average price per preferred share on a Brazilian stock exchange on which the greatest number of such shares were sold on the day of deposit; or (2) if no preferred shares were sold on that day, the average price on the Brazilian stock exchange on which the greatest number of preferred shares were sold in the 15 trading sessions immediately preceding such deposit. In such a case, the difference between the amount previously registered and the average price of the preferred shares calculated as above, will be considered a capital gain. Such taxation is not applicable in case of investors registered under Resolution No. 2,689 which are not located in a tax haven jurisdiction. The withdrawal of ADSs in exchange for preferred shares is not subject to Brazilian tax. On receipt of the underlying preferred shares, the non-Brazilian holder registered under Resolution No. 2,689 will be entitled to register the U.S. dollar value of such shares with the Central Bank as described below in ''—Registered Capital.''

Non-Brazilian holders are not subject to tax in Brazil on gains realized on sales of preferred shares that occur abroad to non-Brazilian holders. Non-Brazilian holders registered under Resolution No. 2,689 which are not located in a tax haven jurisdiction are subject to income tax imposed at a rate of 15% on gains realized on sales or exchanges of the preferred shares that occur in Brazil or with a resident of Brazil, other than in connection with transactions on the Brazilian stock, future or commodities exchange. With reference to proceeds of a redemption or of a liquidating distribution with respect to the preferred shares, the difference between the amount effectively received by the shareholder and the amount of foreign currency registered with the Central Bank, translated into *reais* at the commercial market rate on the date of the redemption or liquidating distribution, will be also subject to income tax at a rate of 15% once such transactions are treated as a sale or exchange carried out of the Brazilian stock, future and commodities exchange.

Gains realized arising from transactions on the Brazilian stock, future or commodities exchanges by an investor registered under Resolution No. 2,689 which is not located in a tax haven jurisdiction are exempt from Brazilian income tax. As of January 1, 2000, the preferential treatment under Resolution No. 2,689 is no longer applicable if the non-Brazilian holder of the ADSs or preferred shares is resident in a tax haven jurisdiction in accordance with Law No. 9,959 of January 27, 2000. As a consequence, gains realized on transactions performed by such holder on the Brazilian stock, futures or commodities exchange are subject to income tax at a rate of 20%, except if such gains are obtained on the spot market of the São Paulo Stock Exchange or on variable funds, in which case the applicable rate is 10% (to be increased to 20% as of January 1, 2002).

Therefore, non-Brazilian holders are subject to income tax imposed at a rate of 10% (20% as of January 1, 2002), on gains realized on sales or exchanges in the spot market in Brazil of preferred shares that occur on the São Paulo Stock Exchange unless such a sale is made by a non-Brazilian holder which is not resident in a tax haven jurisdiction (1) and such sale is made within five business days of the withdrawal of such preferred shares in exchange for ADSs and the proceeds thereof are remitted abroad within such five-day period, or (2) such sale is made under Resolution No. 2,689 by registered non-Brazilian holders who obtain registration with the Brazilian Securities Commission. The ''gain realized'' is the difference between the amount in *reais* realized on the sale or exchange and the acquisition cost measured in *reais*, without any correction for inflation, of the shares sold. The ''gain realized'' as a result of a transaction that occurs other than on the São Paulo Stock Exchange will be the positive difference between the amount realized on the sale or exchange and the acquisition cost of the preferred shares, both such values to be taken into account in *reais*; there are grounds, however, to hold that the ''gain realized'' should be calculated based on the foreign currency amount registered with the Central Bank, such foreign currency amount to be translated into *reais* at the commercial market rate on the date of such sale or exchange. There is no assurance that the current preferential treatment for holders of the ADSs and some non-Brazilian holders of the preferred shares under Resolution No. 2,689 will continue in the future. Any exercise of preemptive rights relating to the preferred shares will not be subject to Brazilian taxation. Any gain on the sale or assignment of preemptive rights relating to the preferred shares by the depositary on behalf of holders of the ADSs will be subject to Brazilian income taxation according to the same rules applicable to the sale or disposition of preferred shares, unless such sale or assignment is performed on the São Paulo Stock Exchange by an investor under Resolution No. 2,689 who is not a resident in a tax haven jurisdiction, in which case the gains are exempt from income tax.

Taxation on Interest on Shareholders' Equity. Any payment of interest on shareholders' equity (see ''Dividends and Dividend Policy—Additional Payments on Shareholders' Equity'') to holders of ADSs or preferred shares, whether or not they are Brazilian residents, is subject to Brazilian withholding tax at the rate of 15% at the time Embraer records such liability, whether or not the effective payment has been made at that time. In the case of non-Brazilian residents that are resident in a tax haven jurisdiction, the applicable rate for income tax is 25%.

Taxation of Foreign Exchange Transactions (''IOF/Câmbio''). Pursuant to Decree No. 2,219 of May 2, 1997, the conversion into Brazilian currency of proceeds received by a Brazilian entity from a foreign investment in the Brazilian securities market (including those in connection with an investment in preferred shares or the ADSs and those under Resolution No. 2,689) and the conversion into foreign currency of proceeds received by a non-Brazilian holder is subject to a tax on exchange transactions known as IOF, which is currently zero. However, according to Law No. 8,894/94, the IOF/Câmbio rate may be increased at any time to a maximum of 25% by a decision of the Minister of Finance, but only in relation to future exchange transactions.

Taxation on Bonds and Securities Transactions (''IOF/Tĭtulos''). Law No. 8,894/94 created the Tax on Bonds and Securities Transactions, or IOF/Tĭtulos, which may be imposed on any transactions involving bonds and securities, even if these transactions are performed on the Brazilian stock, futures or commodities exchange. As a general rule, the rate of this tax is currently zero but the executive branch may increase such rate up to 1.5% per day, but only with respect to future transactions.

Other Brazilian Taxes. There are no Brazilian inheritance, gift or succession taxes applicable to the ownership, transfer or disposition of preferred shares or ADSs by a non-Brazilian holder, except for gift and inheritance taxes which are levied by some states of Brazil on gifts made or inheritances bestowed by individuals or entities not resident or domiciled in Brazil within such state to individuals or entities resident or domiciled within such state in Brazil. There are no Brazilian stamp, issue, registration, or similar taxes or duties payable by holders of preferred shares or ADSs.

Transactions on Bank Accounts (''CPMF''). As a general rule, the *Contribuição Provisória sobre Movimentação Financeira,* the tax on transactions on bank accounts, or CPMF, is imposed on any debit to bank accounts. Therefore, transactions by the depositary or by holders of preferred shares which involve the transfer of Brazilian currency through Brazilian financial institutions will be subject to the CPMF tax. This includes when a non-Brazilian holder transfers the proceeds from the sale or assignment of preferred shares by an exchange transaction, in which case the CPMF tax shall be levied on the amount to be remitted abroad in *reais*. If we have to perform any exchange transaction in connection with ADSs or preferred shares, we will also be subject to the

CPMF tax. The CPMF tax is imposed generally on bank account debits, at a rate of .38%. Although the CPMF tax is set to expire on June 16, 2002, the Brazilian Congress is discussing the possibility of converting this tax into a permanent tax. The responsibility for the collection of the CPMF tax is borne by the financial institution that carries out the relevant financial transaction. Additionally, when the non-Brazilian holder remits the proceeds from the sale or assignment of preferred shares by means of a foreign exchange transaction, the CPMF tax should be levied on the amount to be remitted abroad in *reais*. If we have to perform any exchange transaction in connection with ADSs or preferred shares, we will bear the CPMF tax.

Beneficiaries Resident or Domiciled in Tax Havens or Low Tax Jurisdictions. Law No. 9,779, dated as of January 1, 1999, states that, with the exception of limited prescribed circumstances, income derived from operations by a beneficiary, resident or domiciled in a country considered a tax haven is subject to withholding income tax at the rate of 25%. Tax havens are considered to be countries which do not impose any income tax or which impose such tax at a maximum rate of less than 20%. Accordingly, if the distribution of interest attributed to shareholders' equity is made to a beneficiary resident or domiciled in a tax haven jurisdiction, the applicable income tax rate will be 25% instead of 15%. Capital gains are not subject to this 25% tax, even if the beneficiary is resident in a tax haven jurisdiction. See ''—Taxation of Gains.''

Registered Capital. The amount of an investment in preferred shares held by a non-Brazilian holder who obtains registration under Resolution No. 2,689, or by the depositary representing such holder, is eligible for registration with the Central Bank; such registration (the amount so registered being called registered capital) allows the remittance outside Brazil of foreign currency, converted at the commercial market rate, acquired with the proceeds of distributions on, and amounts realized with respect to dispositions of, such preferred shares. The registered capital for each preferred share purchased as part of the international offering, or purchased in Brazil after the date hereof, and deposited with the depositary will be equal to its purchase price (in U.S. dollars). The registered capital for a preferred share that is withdrawn upon surrender of an ADS will be the U.S. dollar equivalent of:

- the average price of a preferred share on the Brazilian stock exchange on which the greatest number of such shares were sold on the day of withdrawal; or
- if no preferred shares were sold on that day, the average price on the Brazilian stock exchange on which the greatest number of preferred shares were sold in the 15 trading sessions immediately preceding such withdrawal.

The U.S. dollar value of the average price of preferred shares is determined on the basis of the average of the U.S. dollar/*real* commercial market rates quoted by the Central Bank information system on that date (or, if the average price of preferred shares is determined under the second option above, the average of such average quoted rates on the same 15 dates used to determine the average price of preferred shares).

A non-Brazilian holder of preferred shares may experience delays in effecting such registration, which may delay remittances abroad. Such a delay may adversely affect the amount, in U.S. dollars, received by the non-Brazilian holder. See ''Risk Factors—Risks Relating to Brazil—Fluctuations in the value of the *real* against the value of the U.S. dollar 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.''

U.S. Federal Income Tax Consequences

In general, for U.S. federal income tax purposes, U.S. holders that are beneficial owners of ADSs will be treated as the beneficial owners of the preferred shares represented by those ADSs.

Taxation of Dividends. Distributions with respect to the preferred shares or the ADSs (other than distributions in redemption of the preferred shares subject to Section 302(b) of the U.S. Internal Revenue Code of 1986 (also called the Code) or in a liquidation of Embraer) (including distributions of notional interest charges attributed to shareholders' equity, as described above in ''—Brazilian Tax Consequences—Taxation on Interest on Shareholders' Equity'') will, to the extent made from current or accumulated earnings and profits of Embraer as determined under U.S. federal income tax principles, constitute dividends for U.S. federal income tax purposes. Whether such current or accumulated earnings and profits will be sufficient for all such distributions on the preferred shares or ADSs to qualify as dividends for U.S. federal income tax purposes depends on the future profitability of Embraer and other factors, many of which are beyond our control. To the extent that such a distribution exceeds the amount of Embraer's earnings and profits, it will be treated as a non-taxable return of capital to the extent of the U.S. holder's adjusted tax basis in the preferred shares or ADSs, and thereafter as capital gain (provided that the preferred shares or ADSs are held as capital assets). As used below, the term ''dividend'' means a distribution that constitutes a dividend for U.S. federal income tax purposes. Cash dividends (including amounts withheld in respect of Brazilian taxes) paid with respect to:

- the preferred shares generally will be includible in the gross income of a U.S. holder as ordinary income on the day on which the dividends are received by the U.S. holder; or
- the preferred shares represented by ADSs generally will be includible in the gross income of a U.S. holder as ordinary income on the day on which the dividends are received by the depositary; and, in either case, these dividends will not be eligible for the dividends received deduction allowed to corporations.

Dividends paid in *reais* will be includible in the income of a U.S. holder in a U.S. dollar amount calculated by reference to the exchange rate in effect on the day they are received by the U.S. holder, in the case of preferred shares, or the depositary, in the case of preferred shares represented by ADSs.

If dividends paid in *reais* are converted into U.S. dollars on the day they are received by the U.S. holder or the depositary, as the case may be, U.S. holders should not be required to recognize foreign currency gain or loss in respect of the dividend income. Generally, any gain or loss resulting from currency exchange fluctuations during the period from the date the dividend payment is included in the gross income of a U.S. holder through the date such payment is converted into dollars (or otherwise disposed of) will be treated as U.S. source ordinary income or loss. However, U.S. holders should consult their own tax advisors regarding the treatment of any foreign currency gain or loss if any *reais* received by the U.S. holder or the depositary are not converted into U.S. dollars on the date of receipt.

Dividends received by most U.S. holders will constitute foreign source ''passive income'' or, in the case of some U.S. holders such as banks, ''financial services'' income for U.S. foreign tax credit purposes. Subject to limitations under U.S. federal income tax law concerning credits or deductions for foreign taxes, the Brazilian withholding tax will be treated as a foreign income tax eligible for credit against a U.S. holder's U.S. federal income tax liability (or at a U.S. holder's election, may be deducted in computing taxable income). U.S. holders are urged to consult their tax advisors regarding the availability of the foreign tax credit under their particular circumstances. The Internal Revenue Service, or IRS, has expressed concern that intermediaries in connection with depository arrangements may be taking actions that are inconsistent with the claiming of foreign tax credits by U.S. persons who are holders of depositary shares. Accordingly, investors should be aware that the discussion above regarding the creditability of Brazilian withholding tax on dividends paid with respect to preferred shares represented by ADSs could be affected by future action taken by the IRS.

Section 305 of the Code provides special rules for the tax treatment of preferred stock. According to the U.S. Treasury Regulations under that section, the term preferred stock generally refers to stock which enjoys limited rights and privileges (generally associated with specified dividend and liquidation priorities), but does not participate in corporate growth to any significant extent. While the preferred shares have some preferences over our common shares, the preferred shares are not fixed as to dividend payments or liquidation value; thus, it is not entirely clear whether the preferred shares will be treated as ''preferred stock'' or ''common stock'' within the meaning of section 305 of the Code. If the preferred shares are treated as ''common stock'' for purposes of section 305, distributions to U.S. holders of additional shares of such ''common stock'' or preemptive rights relating to such ''common stock'' with respect to their preferred shares or ADSs that are made as part of a pro rata distribution to all our shareholders likely will not be treated as dividend income for U.S. federal income tax purposes. On the other hand, if the preferred shares are treated as ''preferred stock'' within the meaning of section 305, then, in addition to being taxable on cash distributions as described above, a U.S. holder will be taxable on distributions of additional shares or preemptive rights (including amounts withheld in respect of any Brazilian taxes). In that event, the amount of such distribution (and the basis of the new shares or preemptive rights so received) will equal the fair market value of the shares or preemptive rights on the date of distribution.

Taxation of Capital Gains. Deposits and withdrawals of preferred shares by U.S. holders in exchange for ADSs will not result in the realization of gain or loss for U.S. federal income tax purposes.

Gain or loss realized by a U.S. holder on the sale, redemption or other disposition of preferred shares or ADSs will be subject to U.S. federal income taxation as capital gain or loss in an amount equal to the difference between such U.S. tax holder's adjusted basis in the preferred shares or the ADSs and the amount realized on the disposition. Capital gains of individuals derived with respect to capital assets held for more than one year are eligible for reduced rates of taxation. The deductibility of capital losses is subject to limitations. Any gain or loss realized by a U.S. holder will generally be treated as a U.S. source gain or loss.

If a Brazilian withholding tax is imposed on the sale or disposition of preferred shares or ADSs (see ''—Brazilian Tax Consequences''), the amount realized by a U.S. holder will include the gross amount of the proceeds of such sale or disposition before deduction of the Brazilian withholding tax. The availability of U.S. foreign tax credits for these Brazilian taxes and any Brazilian taxes imposed on distributions that do not constitute dividends for U.S. tax purposes is subject to various limitations and involves the application of rules that depend on a U.S. holder's particular circumstances. U.S. holders are urged to consult their own tax advisors regarding the application of the foreign tax credit rules to their investment in, and disposition of, preferred shares.

Passive Foreign Investment Companies. If during any taxable year of a non-U.S. corporation, 75% or more of the corporation's gross income consists of certain types of ''passive'' income, or the average value during a taxable year of the ''passive assets'' of the corporation (generally assets that generate passive income) is 50% or more of the average value of all the corporation's assets, the corporation will be treated as a ''passive foreign investment company,'' or PFIC, under U.S. federal income tax law. If a corporation is treated as a PFIC, a U.S. holder may be subject to increased tax liability upon the sale of preferred shares or ADSs, or upon the receipt of certain dividends, unless such U.S. holder makes an election to be taxed currently on its pro rata portion of the corporation's income, whether or not such income is distributed in the form of dividends, or otherwise makes a ''mark-to-market'' election with respect to the corporation's stock as permitted by the Code. Based on our operations and business plans, we do not believe that we are currently a PFIC, and do not expect to become a PFIC in the foreseeable future.

Information Reporting and Backup Withholding. Information reporting requirements will apply to dividends in respect of the preferred shares or ADSs or the proceeds received on the sale, exchange, or redemption of the preferred shares or ADSs paid within the United States (and, in some cases, outside of the United States) to U.S. holders other than some exempt recipients (such as corporations), and a 31% backup withholding may apply to such amounts if the U.S. holder fails to provide an accurate taxpayer identification number or to report interest and dividends required to be shown on its federal income tax returns. The amount of any backup withholding from a payment to a U.S. holder will be allowed as a credit against the U.S. holder's U.S. federal income tax liability, provided that the required information is furnished to the IRS.

UNDERWRITERS

Under the terms and subject to the conditions contained in an international underwriting agreement dated the date of this prospectus, the international underwriters named below, for whom Morgan Stanley & Co. Incorporated, Credit Suisse First Boston Corporation and Merrill Lynch, Pierce, Fenner & Smith Incorporated are acting as representatives, have severally agreed to purchase, and the selling shareholders have agreed to sell to them, severally, the number of ADSs indicated below:

Name	Number of ADSs
Morgan Stanley & Co. Incorporated	4,945,792
Credit Suisse First Boston Corporation	4,945,792
Merrill Lynch, Pierce, Fenner & Smith Incorporated	4,945,792
Total	14,837,376

We, Cia. Bozano and certain of the selling shareholders have entered into a Brazilian underwriting agreement with Morgan Stanley Dean Witter D.T.V.M. S.A., Unibanco—União de Bancos Brasileiros S.A. and BB Banco de Investimento, S.A. providing for the concurrent offer and sale of preferred shares in Brazil. The closings of the international and Brazilian offerings are conditioned upon each other.

The underwriters are offering the ADSs subject to their acceptance of the ADSs from the selling shareholders and subject to prior sale. The international underwriting agreement provides that the obligations of the several international underwriters to pay for and accept delivery of the ADSs offered by this prospectus are subject to the approval of certain legal matters by their counsel and to certain other conditions. The international underwriters are obligated to take and pay for all of the ADSs offered by this prospectus if any such ADSs are taken. However, the international underwriters are not required to take or pay for the ADSs covered by the international underwriters' over-allotment option described below.

In the agreement between international underwriters and Brazilian underwriters, sales may be made between international underwriters and Brazilian underwriters of any number of ADSs or preferred shares as may be mutually agreed. The per share price of any ADSs sold by the international underwriters shall be the public offering price listed on the cover page of this prospectus, in U.S. dollars, less an amount not greater than the per ADS amount of the concession to dealers described below.

The international underwriters initially propose to offer part of the ADSs directly to the public at the public offering price listed on the cover page of this prospectus and part to certain dealers at a price that represents a concession not in excess of US$.60 an ADS under the public offering price. After the initial offering of the ADSs, the offering price and other selling terms may from time to time be varied by the representatives.

The selling shareholders in the international and Brazilian offerings have granted to the international and Brazilian underwriters an option, exercisable for 30 days from the date of this prospectus, to purchase up to an aggregate of 10,059,236 additional preferred shares, including preferred shares in the form of ADSs, at the public offering price listed on the cover page of this prospectus, less underwriting discounts and commissions. The international underwriters may exercise this option solely for the purpose of covering overallotments, if any, made in connection with the offering of the ADSs offered by this prospectus. To the extent the option is exercised, each international underwriter will become obligated, subject to certain conditions, to purchase about the same percentage of the additional ADSs as the number listed next to the international underwriter's name in the preceding table bears to the total number of ADSs listed next to the names of all international underwriters in the preceding table. If the international underwriters' option is exercised in full, the total price to the public would be US$663,750,000, the total underwriters' discounts and commissions would be US$15,764,489 and total proceeds to the selling shareholders would be US$647,985,511.

The international underwriters have informed the selling shareholders that they do not intend sales to discretionary accounts to exceed five percent of the total number of ADSs offered by them.

Each of Embraer, its directors and executive officers, the selling shareholders and certain other stockholders of Embraer has agreed that, without the prior written consent of Morgan Stanley & Co. Incorporated on behalf of the international underwriters, it will not, during the period ending 90 days after the date of this prospectus:

- offer, pledge, sell, contract to sell, sell any option or contract to purchase, purchase any option or contract to sell, grant any option, right or warrant to purchase, lend or otherwise transfer or dispose of, directly or indirectly, any common shares, preferred shares or ADSs or any securities convertible into or exercisable or exchangeable for such common shares, preferred shares or ADSs; or
- enter into any swap or other arrangement that transfers to another, in whole or in part, any of the economic consequences of ownership of such common shares, preferred shares or ADSs;

whether any transaction described above is to be settled by delivery of such common shares, preferred shares or ADSs or such other securities, in cash or otherwise.

The restrictions described in this paragraph do not apply to:

- the sale of ADSs or preferred shares to the international underwriters or the Brazilian underwriters;
- the sale of exchangeable notes by BNDES or the exchange of such notes for ADSs representing Embraer's preferred shares;
- the issuance by Embraer of (1) options pursuant to existing management and/or employee option plans of which the underwriters have been advised in writing and (2) shares of common or preferred stock upon the exercise of an option issued pursuant to such management and/or employee option plan or any other option, warrant or the conversion of a security outstanding on the date of this prospectus of which the underwriters have been advised in writing;
- transactions by any person other than Embraer relating to common shares, preferred shares or ADSs or other securities acquired in open market transactions after the completion of the offering of the ADSs;
- the sale by BNDESPAR of up to 1,850,000 preferred shares sold as part of a basket of securities in a public offering in Brazil; or
- the sale of up to 600,000 preferred shares in the aggregate by directors and executive officers of Embraer.

In order to facilitate the offering of the ADSs, the international underwriters may engage in transactions that stabilize, maintain or otherwise affect the price of the ADSs. Specifically, the international underwriters may sell more ADSs than they are obligated to purchase under the underwriting agreement, creating a short position. A short sale is covered if the short position is no greater than the number of ADSs available for purchase by the international underwriters under the over-allotment option. The international underwriters can close out a covered short sale by exercising the over-allotment option or purchasing ADSs in the open market. In determining the source of ADSs to close out a covered short sale, the international underwriters will consider, among other things, the open market price of ADSs compared to the price available under the over-allotment option. The international underwriters must close out any naked short position by purchasing ADSs in the open market. A naked short position is more likely to be created if the international underwriters are concerned that there may be downward pressure on the price of the ADSs in the open market after pricing that could adversely affect investors who purchase in this offering. As an additional means of facilitating this offering, the international underwriters may bid for, and purchase ADSs in the open market to stabilize the price of the ADSs. The underwriting syndicate may also reclaim selling concessions allowed to an international underwriter or a dealer for distributing the ADSs in this offering, if the syndicate repurchases previously distributed ADSs to cover syndicate short positions or to stabilize the price of the ADSs. These activities may raise or maintain the market price of the ADSs above independent market levels or prevent or retard a decline in the market price of the ADSs. The international underwriters are not required to engage in these activities, and may end any of these activities at any time. On the date of this prospectus, Morgan Stanley & Co. Incorporated, on behalf of the international underwriters, purchased in such transactions on the New York Stock Exchange an aggregate of 23,000 ADSs at US$38.90 per ADS.

We, the selling shareholders in the international offering and the underwriters have agreed to indemnify each other against a variety of liabilities, including liabilities under the Securities Act.

From time to time, some of the international underwriters have provided, and continue to provide, investment banking services to Embraer and the selling shareholders.

The selling shareholders have generally agreed to pay the costs and expenses relating to this offering, which are estimated to be approximately US$1,500,000, including approximately US$270,000 for filing and listing fees and US$1,000,000 for accounting, legal and printing fees and expenses.

It is expected that delivery of the ADSs will be made against payment therefor on the date specified on the cover page of this prospectus, which will be the fifth business day following the date of pricing of this offering. Under Rule 15c6-1 under the Exchange Act, trades in the secondary market generally are required to settle in three business days, unless the parties to any such trade expressly agree otherwise. Accordingly, purchasers who wish to trade ADSs on the date of pricing or the next succeeding five business days will be required, because the ADSs initially will settle in five business days, to specify an alternate settlement cycle at the time of any such trade to prevent failed settlement. Purchasers of ADSs who wish to trade ADSs on the date of pricing or the next succeeding five business days should consult their own advisor.

VALIDITY OF SECURITIES

The validity of the ADSs will be passed upon for us and the selling shareholders by Shearman & Sterling, New York, New York, and for the international underwriters by Simpson Thacher & Bartlett, New York, New York. The validity of the preferred shares and matters governed by Brazilian law will be passed upon for us by Carlos Rocha Villela, our Executive Vice President—Legal Counsel, and for the international underwriters by Mattos Filho, Veiga Filho, Marrey Jr. e Quiroga Advogados, São Paulo, Brazil.

EXPERTS

Our audited financial statements at and for the years ended December 31, 1998, 1999 and 2000 included in this prospectus have been included in reliance on the report of Arthur Andersen S/C, independent certified public accountants, given on the authority of that firm as experts in auditing and accounting.

With respect to our unaudited interim financial statements at and for the three months ended March 31, 2000 and 2001, Arthur Andersen S/C reported that it has applied limited procedures in accordance with professional standards for a review of that information. However, their separate report thereon states that they did not audit and they do not express an opinion on our unaudited financial information. Accordingly, the degree of reliance on their report on that information should be restricted in light of the limited nature of the review procedures applied. Arthur Andersen S/C is not subject to the liability provisions of Section 11 of the Securities Act for their report on our unaudited interim financial statement information because that report is not a ''report'' or a ''part'' of the registration statement prepared or certified by Arthur Andersen S/C within the meaning of Sections 7 and 11 of the Securities Act.

WHERE YOU CAN FIND MORE INFORMATION ABOUT US

We are subject to the periodic reporting and other informational requirements of the Exchange Act. Accordingly, we are required to file reports and other information with the U.S. Securities and Exchange Commission, or the Commission. You may inspect and copy reports and other information to be filed by us at the public reference facilities maintained by the Commission at 450 Fifth Street, N.W., Washington D.C. 20549, and at the Commission's Regional Offices located at Citicorp Center, 500 West Madison Street, Suite 1400, Chicago, Illinois 60661 and 7 World Trade Center, 7th Floor, New York, New York 10048. You may obtain copies of these materials upon written request from the Public Reference Section of the Commission at 450 Fifth Street, N.W., Washington, D.C. 20549, at prescribed rates. You may also inspect and copy this material at the offices of the New York Stock Exchange, Inc., 20 Broad Street, New York, New York 10005. In addition to the public reference facilities maintained by the Commission and the New York Stock Exchange, you may obtain the registration statement, upon written request from the depositary for the ADSs at its corporate trust office located at 60 Wall Street, New York, New York.

We have also filed with the Commission a registration statement (including amendments and exhibits to the registration statement) on Form F-1 under the U.S. Securities Act. This prospectus does not contain all of the information set forth in the registration statement, parts of which are omitted in accordance with the rules and regulations of the Commission. For further information, we refer you to the registration statement.

SERVICE OF PROCESS AND ENFORCEMENT OF JUDGMENTS

Brazil

We and each of PREVI, SISTEL and BNDESPAR, collectively referred to as the Brazilian selling shareholders, are incorporated under the laws of Brazil. Substantially all of our assets and those of the Brazilian selling shareholders are located in Brazil. All of our directors and officers and some of the advisors named herein reside in Brazil and all of the Brazilian selling shareholders' officers and directors reside in Brazil. As a result, it may not be possible for investors to effect service of process within the United States upon such persons or to enforce against them or us in U.S. courts judgments predicated upon the civil liability provisions of the federal securities laws of the United States.

We have been advised by our Executive Vice President—Legal Counsel, Carlos Rocha Villela, that judgments of U.S. courts for civil liabilities based upon the federal securities laws of the United States may be, subject to the requirements described below, enforced in Brazil. A judgment against us, any of the Brazilian selling shareholders or the persons described above obtained outside Brazil would be enforceable in Brazil without reconsideration of the merits, upon confirmation of that judgment by the Brazilian Federal Supreme Court. That confirmation will occur if the foreign judgment:

- fulfills all formalities required for its enforceability under the laws of the country where the foreign judgment is granted;
- is issued by a competent court after proper service of process is made in accordance with Brazilian law;
- is not subject to appeal;
- is for a sum certain;
- is authenticated by a Brazilian consular office in the country where the foreign judgment is issued and is accompanied by a sworn translation into Portuguese; and
- is not contrary to Brazilian national sovereignty, public policy or public morality.

We and the Brazilian selling shareholders have been further advised by our Brazilian counsel that:

- original actions based on the federal securities laws of the United States may be brought in Brazilian courts and that, subject to Brazilian public policy and national sovereignty, Brazilian courts will enforce liabilities in such actions against us, our directors, our executive officers, the Brazilian selling shareholders and the advisors named in this prospectus; and
- the ability of a judgment creditor or the other persons named above to satisfy a judgment by attaching our assets or those of any of the Brazilian selling shareholders is limited by provisions of Brazilian law.

A plaintiff (whether Brazilian or non-Brazilian) residing outside Brazil during the course of litigation in Brazil must provide a bond to guarantee court costs and legal fees if the plaintiff owns no real property in Brazil that could secure such payment. The bond must have a value sufficient to satisfy the payment of court fees and defendant's attorney fees, as determined by a Brazilian judge. This requirement does not apply to the enforcement of foreign judgments which have been duly confirmed by the Brazilian Federal Supreme Court.

Cayman Islands

Bozano Holdings Ltd. is a Cayman Islands holding company. The Cayman Islands has a less developed body of securities laws as compared to the United States and provides protections for investors to a significantly lesser extent.

A substantial majority of the assets of Bozano Holdings Ltd. are located outside the United States. In addition, a majority of the directors and officers of Bozano Holdings Ltd. are nationals and/or residents of countries other than the United States, and all or a substantial portion of Bozano Holdings Ltd.'s or such persons' assets are located outside the United States. As a result, it may be difficult for you to effect service of process within the United States upon Bozano Holdings Ltd. or such persons or to enforce against them or against Bozano Holdings Ltd., judgments obtained in United States courts, including judgments predicated upon the civil liability provisions of the securities laws provisions of the United States or any state thereof.

Maples and Calder, counsel to Bozano Holdings Ltd. as to Cayman Islands law, has advised Bozano Holdings Ltd. that there is uncertainty as to whether the courts of the Cayman Islands would:

- recognize or enforce judgments of United States courts obtained against Bozano Holdings Ltd. or such persons predicated upon the civil liability provisions of the securities laws of the United States or any state thereof; or
- be competent to hear original actions brought in each respective jurisdiction, against Bozano Holdings Ltd. or such persons predicated upon the civil liability provisions of the securities laws of the United States or any state thereof.

Maples and Calder has further advised Bozano Holdings Ltd. that a final and conclusive judgment in federal or state courts of the United States under which a sum of money is payable, other than a sum payable in respect of taxes, fines, penalties or similar charges, may be subject to enforcement proceedings as a debt in the courts of the Cayman Islands under the common law doctrine of obligations.

INDEX TO FINANCIAL STATEMENTS

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Management and Shareholders of
Embraer-Empresa Brasileira de Aeronáutica S.A.:

(1) We have audited the accompanying consolidated balance sheets of EMBRAER-EMPRESA BRASILEIRA DE AERONÁUTICA S.A. (a Brazilian corporation) and subsidiaries as of December 31, 1998, 1999 and 2000, and the related statements of income, changes in shareholders' equity, and changes in financial position for the years then ended, all expressed in constant Brazilian reais as of March 31, 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements.

(2) We conducted our audits in accordance with generally accepted auditing standards in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

(3) In our opinion, the consolidated financial statements referred to in paragraph (1) present fairly, in all material respects, the financial position of Embraer-Empresa Brasileira de Aeronáutica S.A. and subsidiaries as of December 31, 1998, 1999 and 2000, and the results of their operations, the changes in shareholders' equity, and the changes in their financial position for the years then ended in conformity with generally accepted accounting principles in Brazil.

(4) Generally accepted accounting principles in Brazil vary in certain respects from generally accepted accounting principles in the United States of America. Application of generally accepted accounting principles in the United States of America would have affected shareholders' equity as of December 31, 1998, 1999 and 2000 and the results of operations for the years then ended to the extent summarized in Note 30 of the consolidated financial statements.

São Paulo, Brazil,

March 1, 2001 (except for Note 2.b.1 as to which the date is April 5, 2001)

ARTHUR ANDERSEN S/C

EMBRAER-EMPRESA BRASILEIRA DE AERONÁUTICA S.A.

CONSOLIDATED BALANCE SHEETS AT DECEMBER 31, 1998, 1999 AND 2000

(Expressed in thousands of constant Brazilian *reais* as of March 31, 2001)

	Notes	1998	1999	2000
ASSETS				
CURRENT ASSETS:				
Cash and cash equivalents	(4)	420,375	611,255	2,358,602
Trade accounts receivable	(5)	203,682	274,405	347,336
Allowance for doubtful accounts	(5)	(3,147)	(22,347)	(28,853)
Recoverable taxes	(6)	24,855	33,509	8,868
Deferred income taxes	(29)	5,838	114,175	230,725
Other receivables	(7)	32,451	44,574	40,788
Inventories	(8)	964,194	1,551,385	1,210,199
Prepaid expenses		11,215	10,471	17,671
Total current assets		1,659,463	2,617,427	4,185,336
NONCURRENT ASSETS:				
Marketable securities		2,922	—	—
Trade accounts receivable	(5)	39,394	377,086	45,092
Recoverable taxes	(6)	2,274	3,815	4,569
Compulsory loans, guarantee and other deposits		9,635	7,705	11,200
Other receivables	(7)	33,799	61,723	67,691
Deferred income taxes	(29)	242,232	311,638	171,377
Total noncurrent assets		330,256	761,967	299,929
PERMANENT ASSETS:				
Investments	(9)	5,791	6,832	8,229
Property, plant and equipment	(10)	460,810	521,769	673,923
Deferred charges	(11)	566,387	412,243	367,010
Total permanent assets		1,032,988	940,844	1,049,162
Total assets		3,022,707	4,320,238	5,534,427

The accompanying notes are an integral part of these balance sheets.

EMBRAER-EMPRESA BRASILEIRA DE AERONÁUTICA S.A.

CONSOLIDATED BALANCE SHEETS AT DECEMBER 31, 1998, 1999 AND 2000

(Expressed in thousands of constant Brazilian *reais* as of March 31, 2001)

	Notes	1998	1999	2000
LIABILITIES AND SHAREHOLDERS' EQUITY				
CURRENT LIABILITIES:				
Loans	(13)	891,477	1,108,536	726,922
Suppliers	(12)	333,449	399,464	528,576
Accounts payable	(15)	47,899	58,709	128,288
Customers' advances	(14)	235,675	439,576	581,554
Taxes and social charges payable	(16)	32,905	83,149	151,806
Accrued taxes on income		3,558	29,183	79,155
Dealers and sales agents		3,751	393	1,278
Accrued liabilities	(17)	80,653	135,171	363,889
Dividends	(18)	45,477	96,787	149,853
Accrued interest on debentures	(19)	—	2,037	1,823
Deferred income tax	(29)	—	7,016	1,360
Total current liabilities		1,674,844	2,360,021	2,714,504
LONG-TERM LIABILITIES:				
Loans	(13)	200,736	160,697	180,026
Suppliers	(12)	6,038	—	—
Accounts payable	(15)	16,121	43,284	284,564
Customers' advances	(14)	157,635	224,679	161,040
Long-term portion of refinanced taxes	(16)	71,939	60,351	53,277
Accrued liabilities	(17)	82,531	42,685	28,481
Debentures	(19)	—	201,282	180,200
Deferred income tax	(29)	104,184	167,298	149,849
Total long-term liabilities		639,184	900,276	1,037,437
DEFERRED INCOME		928	431	415
MINORITY INTEREST		—	—	20,401
SHAREHOLDERS' EQUITY:	(20)			
Capital		713,762	713,762	1,205,092
Capital reserves		—	182	32,156
Income reserves		9,561	345,566	524,422
Accumulated deficit		(15,572)	—	—
Total shareholders' equity		707,751	1,059,510	1,761,670
Total liabilities and shareholders' equity		3,022,707	4,320,238	5,534,427

The accompanying notes are an integral part of these balance sheets.

EMBRAER-EMPRESA BRASILEIRA DE AERONÁUTICA S.A.

CONSOLIDATED STATEMENTS OF INCOME
FOR THE YEARS ENDED DECEMBER 31, 1998, 1999 AND 2000

(Expressed in thousands of constant Brazilian *reais* as of March 31, 2001, except for income per share)

	Notes	1998	1999	2000
SALES:				
Gross sales—				
Domestic market		228,366	183,803	113,108
Foreign market		1,890,834	3,912,343	5,443,008
Sales taxes		(14,631)	(14,994)	(10,926)
Other sales deductions		—	(21,355)	(127,714)
Net sales		2,104,569	4,059,797	5,417,476
COST OF SALES		(1,564,344)	(2,656,381)	(3,915,938)
Gross profit		540,225	1,403,416	1,501,538
OPERATING EXPENSES:				
Administrative		(70,905)	(103,052)	(153,409)
Selling		(170,040)	(256,242)	(369,343)
Other expenses, net	(26)	(40,406)	(213)	(55,396)
Equity in unconsolidated subsidiary		218	(283)	1,493
Employee profit sharing	(23)	(22,198)	(42,188)	(81,684)
Income from operations before financial income (expenses)		236,894	1,001,438	843,199
FINANCIAL INCOME (EXPENSES):				
Interest expense	(24)	(97,697)	(150,018)	(186,257)
Interest income	(24)	61,238	31,450	104,169
Monetary and exchange variations, net	(25)	(70,833)	(340,051)	(2,901)
Income from operations after financial income (expenses)		129,602	542,819	758,210
NONOPERATING INCOME (EXPENSE), NET	(27)	(5,135)	(58,975)	22,473
INCOME BEFORE INCOME TAX		124,467	483,844	780,683
INCOME TAX BENEFIT (PROVISION)	(29)	(15,689)	25,436	(256,594)
INCOME AFTER TAXES		108,778	509,280	524,089
MINORITY INTEREST		—	—	(11,424)
NET INCOME		108,778	509,280	512,665
INCOME PER SHARE OUTSTANDING AT YEAR END, IN BRAZILIAN REAIS		0.23	1.05	0.94

The accompanying notes are an integral part of these financial statements.

EMBRAER-EMPRESA BRASILEIRA DE AERONÁUTICA S.A.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY FOR THE YEARS ENDED DECEMBER 31, 1998, 1999 AND 2000

(Expressed in thousands of constant Brazilian *reais* as of March 31, 2001)

			Income reserves			
	Capital	Capital reserves	Legal reserve	Reserve for investments and working capital	Retained earnings (accumulated deficit)	Total
BALANCE ON DECEMBER 31, 1997	713,762	—	—	—	(40,791)	672,971
Net income	—	—	—	—	108,778	108,778
Legal reserve	—	—	9,561	—	(9,561)	—
Dividends	—	—	—	—	(73,998)	(73,998)
BALANCE ON DECEMBER 31, 1998	713,762	—	9,561	—	(15,572)	707,751
Fiscal incentive reserve—PDTI	—	182	—	—	—	182
Class "B" shares redemption	—	—	—	(15,311)	—	(15,311)
Net income	—	—	—	—	509,280	509,280
Legal reserve	—	—	24,116	—	(24,116)	—
Dividends	—	—	—	—	(142,392)	(142,392)
Reserve for investments and working capital	—	—	—	327,200	(327,200)	—
BALANCE ON DECEMBER 31, 1999	713,762	182	33,677	311,889	—	1,059,510
Capital increase:						
In cash	475,350	—	—	—	—	475,350
Debentures converted into capital	15,980	6,849	—	—	—	22,829
Fiscal incentive	—	25,125	—	—	—	25,125
Net income	—	—	—	—	512,665	512,665
Effect of deferred income taxes on monetary restatement of shareholders' equity	—	—	—	—	(31,225)	(31,225)
Legal reserve	—	—	33,844	—	(33,844)	—
Dividends	—	—	—	—	(196,407)	(196,407)
Interest on capital	—	—	—	—	(106,177)	(106,177)
Reserve for investments and working capital	—	—	—	145,012	(145,012)	—
BALANCE ON DECEMBER 31, 2000	1,205,092	32,156	67,521	456,901	—	1,761,670

The accompanying notes are an integral part of these financial statements.

EMBRAER-EMPRESA BRASILEIRA DE AERONÁUTICA S.A.

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION FOR THE YEARS ENDED DECEMBER 31, 1998, 1999 AND 2000

(Expressed in thousands of constant Brazilian *reais* as of March 31, 2001)

	1998	1999	2000
SOURCES OF FUNDS:			
Provided by operations—			
Net income	108,778	509,280	512,665
Items not affecting working capital—			
Depreciation	47,734	50,892	60,582
Amortization of deferred charges	104,166	134,723	156,845
Net book value of permanent asset disposals	9,404	1,463	3,868
Interest on long-term assets and liabilities Added to principal, net	4,252	3,894	1,961
Net monetary and exchange variations on Long-term items	38,242	9,859	(22,500)
Translation adjustment on consolidated foreign investment	(6,048)	(34,255)	(9,190)
Provision for losses	725	9,352	13,883
Write-off of long-term doubtful accounts	7,696	—	—
Reversal of deferred income	(1,069)	(912)	(12)
Write-off of deferred charges	—	58,533	—
Write-off of investments	—	—	68
Long term deferred income and social contribution taxes	11,889	(107,612)	21,526
Equity in unconsolidated subsidiary	(218)	283	(1,493)
Reserve for (reversal of) contingencies	(2,820)	7,019	16,597
Reversal of reserve for losses on contracts	(4,040)	(18,682)	—
Minority interest	—	—	11,424
Funds provided by operations	318,691	623,837	766,224
From shareholders—			
Capital increase	—	—	475,350
From third parties—			
Increase in long-term liabilities—			
Customers' advances	201,322	395,891	159,612
Debentures issued	—	191,901	—
Loans	35,116	191	60,017
Suppliers and other liabilities	17,325	14,519	252,136
Reduction of long-term accounts receivable	32,531	159,582	469,791
Increase in minority interest	—	—	8,977
Funds provided by third parties	286,294	762,084	950,533
Total sources	604,985	1,385,921	2,192,107
APPLICATIONS OF FUNDS:			
Increase in noncurrent assets	64,264	429,931	64,385
Investments	5,341	22	864
Property, plant and equipment	46,439	104,829	216,977
Deferred charges	70,930	38,866	111,612
Transfer to current liabilities—			
Loans	20,036	36,137	36,637
Customers' advances	158,476	301,658	201,971
Other liabilities	109,389	43,988	43,651
Dividends	73,998	142,392	196,407
Class "B" shares redemption	—	15,311	—
Interest on capital	—	—	106,177
Total applications	548,873	1,113,134	978,681
INCREASE IN WORKING CAPITAL	56,112	272,787	1,213,426
WORKING CAPITAL—END OF YEAR:			
Current assets	1,659,463	2,617,427	4,185,336
Current liabilities	1,674,844	2,360,021	2,714,504
	(15,381)	257,406	1,470,832
WORKING CAPITAL—BEGINNING OF YEAR	(71,493)	(15,381)	257,406
INCREASE IN WORKING CAPITAL	56,112	272,787	1,213,426

The accompanying notes are an integral part of these financial statements.

EMBRAER-EMPRESA BRASILEIRA DE AERONÁUTICA S.A.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 1998, 1999 AND 2000

(Amounts in thousands of constant Brazilian *reais* as of March 31, 2001, unless otherwise indicated)

1. Operations

Embraer-Empresa Brasileira de Aeronáutica S.A. (the ''Company'') is engaged in the design, development, production and marketing of a range of jet and turboprop aircraft for regional airline and defense use, of light reciprocating and turboprop aircraft for general aviation, corporate and agricultural uses and of aviation-related structural parts and mechanical and hydraulic systems. In addition, the Company is developing a new line of corporate jets based on one of its regional jets.

2. Basis of Presentation of Financial Statements

a. Presentation of Financial Statements

The financial statements were prepared in accordance with generally accepted accounting principles in Brazil (''Brazilian GAAP'') and additional regulations of the ''Comissão de Valores Mobiliários'', the Brazilian Securities Commission (the ''CVM''), and this English language translation is provided for the convenience of readers outside Brazil.

Certain reclassifications and changes in terminology have been made in relation to the Company's consolidated financial statements previously issued, and the explanatory notes have been modified in order to conform more closely to reporting practices in the United States.

Certain accounting practices applied by the Company and its subsidiaries that conform with generally accepted accounting principles in Brazil may not conform with generally accepted accounting principles in other countries.

The reconciliation between the amounts reported by the Company in its individual financial statements adjusted for inflation as discussed in Note 2.b. below, not presented herein, and the consolidated statements is as follows:

	Net income			Shareholders' equity		
	For the year ended December 31,			At December 31,		
	1998	1999	2000	1998	1999	2000
Company, as adjusted	123,405	518,284	523,333	740,449	1,101,212	1,814,040
Unrealized profit(a)	(14,627)	(9,004)	(10,668)	(32,698)	(41,702)	(52,370)
Consolidated	108,778	509,280	512,665	707,751	1,059,510	1,761,670

(a) Unrealized profit arises from sales by the Company to its subsidiaries, and also among the subsidiaries, of spare parts and marketing rights, and is eliminated in consolidation.

b. Requirements of Brazilian Legislation

Until December 31, 1995, publicly-traded companies were required to prepare financial statements under two methods: (i) the corporate law method, valid for all legal purposes; and (ii) the constant currency method, prepared as price-level adjusted financial statements following the guidelines of the CVM.

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

The corporate law method provided for a simplified method of accounting for the effects of inflation. However, it did not fully recognize the effects of inflation in certain balance sheet accounts or in substantially all captions in the statements of income, changes in financial position and changes in shareholders' equity, and did not require the monetary restatement of prior-year comparative amounts. Under the highly inflationary conditions which prevailed in Brazil until mid-1994, the corporate law method financial statements were essentially not meaningful for analyzing companies' performance by users of financial statements. However, they were, and continue to be, the basis for determining income taxes and shareholders' rights, such as the computation of cash dividends and distribution of share dividends.

Under the constant currency method, all Brazilian currency historical amounts in the financial statements and notes are expressed in the constant purchasing power of that currency at the most recent balance sheet date, in accordance with standards prescribed by the CVM for publicly-traded companies through December 31, 1995. These standards required that all transactions and balances recorded in a company's statutory accounts under the corporate law method be updated to reflect the changes in a selected inflation index from the date they occurred or were generated to the most current balance sheet date.

Although the CVM ceased to require constant currency reporting subsequent to December 31, 1995, Brazilian GAAP continues to require comprehensive inflation accounting.

Accordingly, all relevant nonmonetary assets and liabilities, shareholders' equity accounts, and all components of the statements of income, changes in shareholders' equity and changes in financial position and notes are updated to reflect the changes in the inflation index to March 31, 2001. Also, the gains and losses on monetary assets and liabilities attributable to changes in the index, calculated on a monthly average basis, are allocated to the corresponding income or expense items in the statements of income.

The price-level adjustments to reflect the current purchasing power of the currency do not purport to change the prior-period financial statements in any way, but only to update the amounts to a constant currency measurement unit.

For official purposes (filing with the CVM), the Company published the individual and consolidated financial statements as of and for the years ended December 31, 1998, 1999 and 2000 prepared under the corporate law method.

The principal criteria adopted to prepare the fully indexed consolidated financial statements for the years ended December 31, 1998, 1999 and 2000, in accordance with the practices described in Note 3, were as follows:

b.1. Inflation Restatement Index

The consolidated financial statements of 1998, 1999 and 2000 were indexed and expressed in currency of constant purchasing power of March 31, 2001 using the monthly average values of the ''Índice Geral de Preços de Mercado'' (the General Prices Index—Market or the ''IGP-M'') of the Fundação Getúlio Vargas. Annual inflation rates for the three-year period ended December 31, 2000 and for the three months ended March 31, 2000, as measured by the IGP-M, were as follows:

Period	inflation rate—%
Year ended December 31, 1998 (i)	1.8
Year ended December 31, 1999	20.1
Year ended December 31, 2000	9.9
Three months ended March 31, 2001	1.4

(i) Due to the low level of inflation in 1998, the Company considered the variation of the IGP-M in 1998 equal to 0% for purposes of applying the constant currency method. Management believes that the effect of applying the index of 1.8% would not be material to the Company's financial statements.

b.2. Consolidated Statements of Income for 1998, 1999 and 2000

Items in the consolidated statements of income are adjusted by:

- Allocating inflationary gains or losses on interest-bearing monetary assets and liabilities to their corresponding interest income and expense line items.
- Allocating inflationary gains and losses from other monetary items to their corresponding income or expense line items. Amounts without corresponding income or expense line items were allocated to ''Other expenses, net''.

b.3. Deferred Income Tax Effects of Indexation Adjustments

As a result of legislation mandating the discontinuation of the indexation system for Brazilian corporate law and most fiscal purposes, as from January 1, 1996, the indexation of assets and liabilities for financial reporting purposes used in these financial statements is not permitted for tax purposes. Accordingly, a deferred tax liability arises from the excess of net assets shown for financial reporting purposes over the tax basis of these net assets. The charge relating to the additional deferred tax liability of R$112,946 and R$99,509 in 1999 and 2000, respectively, was recognized net of deferred tax assets arising from loss carryforwards (see Note 29).

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

The reconciliation between the net income and shareholders' equity as of December 31, 1998, 1999 and 2000 under the corporate law method and these financial statements, which includes the effects of full indexation until March 31, 2001, as described above, is as follows:

	Net income For the year ended December 31,			Shareholders' equity At December 31,		
	1998	1999	2000	1998	1999	2000
As reported under the corporate law method:						
Consolidated financial statements	132,046	412,152	645,179	417,874	697,106	1,538,726
Monetary restatement of opening balances	44,793	47,443	9,162	141,766	80,243	21,851
Opening balances monetarily restated	176,839	459,595	654,341	559,640	777,349	1,560,577
Monetary restatement of:						
Other accounts receivable	—	64	(64)	—	64	—
Inventories	(48,301)	72,406	(50,219)	50,524	122,930	72,711
Prepaid expenses	(165)	798	(243)	68	866	623
Customers' advances	1,973	(2,689)	(2,278)	(1,513)	(4,202)	(6,480)
Shareholders' equity	—	(86,889)	(91,832)	—	—	—
Property, plant and equipment	(5,991)	52,733	35,655	55,563	108,296	143,951
Deferred charges	(11,902)	36,899	(18,424)	67,578	104,477	86,053
Investments	(19)	11	(21)	12	23	2
Accounts payable—class "B" Shares	—	—	—	2,257	—	—
Other accounts payable	—	—	267	—	(267)	—
Accrued liabilities	—	8	(8)	—	8	—
Adjustment of provisions for losses on contracts	4,040	18,682	—	(18,682)	—	—
Minority interest	—	—	(4,185)	—	—	(4,185)
Write-off of doubtful account	(7,696)	7,696	—	(7,696)	—	—
Deferred income tax effect of monetary restatement adjustment	—	(112,946)	44,661	—	(112,946)	(99,509)
Additional deferred income tax under constant currency method	—	62,912	(54,985)	—	62,912	7,927
As reported in the accompanying financial statements	108,778	509,280	512,665	707,751	1,059,510	1,761,670

3. Summary of Accounting Policies

a. Consolidation Principles

The financial statements include the accounts of the Company and the following subsidiaries: Embraer Aircraft Corporation—EAC, Embraer Aviation International SAS—EAI, Indústria Aeronáutica Neiva S.A.—NEIVA, Embraer Finance Ltd.—EFL, ELEB—Embraer Liebherr Equipamentos do Brasil S.A., Embraer Services Inc.—ESI, Trumpeter Inc., Embraer Aviation Europe SAS—EAE, Embraer Australia PTY Ltd.—EAL, Embraer Credit Ltd.—ECL and Embraer Europe SARL-EES.

a.1. Operating Activities of Subsidiaries

Embraer Aircraft Corporation—EAC

This wholly-owned subsidiary located in Ft. Lauderdale, Florida, USA, represents the Company commercially in North and Central America, the Caribbean, Australia, Asia, the United Kingdom and Scandinavia, including sales, product support and customer training.

Embraer Aviation International SAS—EAI

This wholly-owned subsidiary located in Le Bourget, near Paris, France, represents the Company in the Continental European, African and Middle East markets by providing after-sale support. This company was transformed from a branch to a subsidiary effective July 1, 2000.

Indústria Aeronáutica Neiva S.A.—NEIVA

This wholly-owned subsidiary located in Botucatu, São Paulo, Brazil, is involved in the production and sale of light executive and agricultural aircraft, as well as the production and assembly of parts for the EMB 120 Brasília, ERJ 145 and ERJ 135 aircraft.

Embraer Finance Ltd.—EFL

This wholly-owned subsidiary located in Cayman Islands, B.W.I., provides support in the purchasing and sales activities of the Company, as well as assisting customers in obtaining financing from third parties.

ELEB—Embraer Liebherr Equipamentos do Brasil S.A. (formerly Órbita Sistemas Aeroespaciais S.A.)

On November 1, 2000, Embraer—Liebherr Equipamentos do Brasil S.A., based in São José dos Campos, São Paulo, Brazil, was merged into Órbita Sistemas Aeroespaciais S.A. Its principal business of producing and selling hydraulic and mechanical equipment for the aviation industry remained unchanged. The company name was changed to ELEB—Embraer Liebherr Equipamentos do Brasil S.A. The Company owns 59.995% of this subsidiary.

Embraer Services Inc.—ESI (previously Green Service Inc.)

This wholly-owned subsidiary located in Dallas, Texas, USA, supports in the United States the development activities for the EMB 145 special configurations contracted under the SIVAM Program (Integrated Surveillance System for the Amazon Region) to carry out remote vigilance and air patrol missions.

Trumpeter Inc.

This wholly-owned subsidiary located in Wilmington, Delaware, USA, has a 25% interest in Expressprop LLC, which provides support for the sale of used EMB 120 Brasília aircraft.

Embraer Aviation Europe SAS—EAE

This wholly-owned subsidiary was formed on June 21, 2000 and is located at Le Bourget, near Paris, France. It is the holding company of Embraer Aviation International SAS—EAI.

Embraer Australia PTY Ltd.—EAL

This wholly-owned subsidiary was formed on June 1, 2000 and is located at Melbourne, Australia. Its purpose is to provide services and after-sales support to customers in Australia, Asia and the Far East.

Embraer Credit Ltd.—ECL

This wholly-owned subsidiary was formed on April 10, 2000 and is located at Wilmington, Delaware, USA. Its purpose is to support sales operations.

Embraer Europe SARL—EES

This wholly-owned subsidiary was formed on September 7, 2000 and is located at Le Bourget, near Paris, France. Its purpose is to provide sales representation for the Company in Europe.

The financial statements of subsidiaries based abroad are prepared according to accounting practices compatible with those used by the Company, and are translated into reais at the exchange rates in effect at the balance sheet dates.

Intercompany balances transactions and unrealized profits are eliminated in consolidation.

Investments in affiliates in which the Company does not have control are accounted for under the equity method.

b. Cash and Cash Equivalents

Cash equivalents are considered to be all highly liquid temporary cash investments with original maturity dates of three months or less.

c. Allowance for Doubtful Accounts

These are recognized based on an analysis of receivables, in an amount considered sufficient to cover possible losses on receivables.

d. Foreign Currency Transactions

Transactions in foreign currency are recorded at the prevailing exchange rate at the time of the related transactions. Foreign currency denominated assets and liabilities are translated using the exchange rate at the balance sheet date. Exchange differences are recognized in the consolidated statements of operations as they occur.

e. Foreign Currency Translation Gains (Losses)

Translation gains and losses arising from the effects of devaluation (or appreciation) of the Brazilian *real* in relation to the U.S. dollar, French franc or Australian dollar, when translating the financial statements of foreign subsidiaries for the computation of equity pickup and consolidation, are allocated to financial expenses.

f. Assets and Liabilities Subject to Monetary Restatement

Accounts subject to monetary restatement are updated based on the indexes defined legally or by contract.

g. Inventories

Stated at production or acquisition average cost monetarily restated, or market value, whichever is lower. Market value is replacement cost for raw materials and net realizable value for work-in-process and finished products. Spare parts are stated at average cost not in excess of realizable value.

h. Other Current and Noncurrent Assets

All other current and noncurrent assets are stated at cost or realizable value, including income earned, when applicable.

i. Permanent Assets

Other investments are stated at monetarily restated cost and reduced by allowances to adjust to market value.

Property, plant and equipment are stated at cost, plus revaluations, monetarily restated. Depreciation is provided on the straight-line method based on the estimated useful lives of the assets. Improvements to existing property are capitalized while maintenance and repair costs are charged to expense as incurred. Materials allocated to specific projects are added to construction-in-progress.

Deferred charges are stated at cost, monetarily restated, and are composed mainly of research and development costs, design costs, project engineering, prototypes and tooling, for subsequent amortization based on the number of aircraft expected to be sold.

j. Loans

These are restated based on monetary and exchange variations, and include the respective charges incurred to the balance sheet date.

k. Customers' Advances

These are restated from the date received through monetary and exchange variation, when applicable.

l. Income and Social Contribution Taxes

Income and social contribution taxes comprise federal income tax and social contribution tax. Deferred taxes are provided on temporary differences to the extent their realization is probable.

m. Accrued Vacations

Vacation accruals payable to employees are recognized as incurred, according to the provisions of the Brazilian Consolidated Labor Laws (CLT), plus additional amounts defined in collective bargaining agreements with labor unions and the related social charges.

n. Product Warranties

Warranty expense is recognized based on estimated amounts to be incurred as a percentage of sales price of the aircraft. The warranty period ranges from two to three years depending on the aircraft parts.

o. Provisions for Contingencies

Provisions for contingencies related to labor, tax, civil and commercial litigation are based on legal advice and management's best estimate as to the likely outcome of the outstanding matters at the balance sheet date.

p. Pension and Post-Retirement Benefits

The Company participates in a defined contribution pension plan that provides pension and other post-retirement benefits for its employees, except for Embraer Aircraft Corporation—EAC, where the plan is a defined benefit plan. Current costs are determined as the amount of required contribution for the period and are recorded on the accrual basis.

q. Other Current and Long-term Liabilities

The remaining current and long-term liabilities are stated at known or estimated amounts, plus the related charges and exchange variations where applicable.

r. Employees' Profit Sharing

Accruals are made for granting employees the right to a share of profits. The amount recorded is the employees' profit sharing attributable to those employees of the Company and its subsidiaries, based on the variable compensation policy approved by the Board of Directors in April 1996.

s. Sales and Other Operating Revenues

Sales under fixed-price-type contracts are generally recognized as deliveries are made or at the completion of contractual billing milestones. Regional aircraft sales are recorded as deliveries are made. In the defense aircraft segment, operations consist principally of performing work under long-term development contracts predominantly for the Brazilian Government and the revenue is recognized in accordance with the "percentage of completion" method. Anticipated losses on contracted sales in the defense aircraft segment are accrued when they are known at their estimated amounts. Actual losses are recognized at the delivery of the related aircraft.

t. Earnings per Share

Earnings per share were calculated based on the number of shares outstanding at the balance sheet dates.

u. Use of Estimates

The preparation of consolidated financial statements requires management to make estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the period reported. Actual results could differ from those estimates.

v. Stock Options

Stock options granted do not result in any expense being recorded. As the options are exercised, the purchase of the stock by the employees will be recorded as an increase in capital stock in the amount of the purchase price.

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

4. Cash and Cash Equivalents

	At December 31,		
	1998	1999	2000
Cash and banks	21,837	20,366	21,643
Short-term investments:			
In Brazilian reais—			
Capitalization bonds	—	5,079	—
Bank certificates of deposit	—	24,255	—
Investments funds	363,699	508,562	1,878,310
In U.S. dollars—			
Time deposits	—	—	449,626
Overnight	34,839	439	9,023
Promissory notes	—	52,554	—
	420,375	611,255	2,358,602

The average annualized interest rates related to the investments made in Brazilian *reais* and in U.S. dollars for the year ended December 31, 2000 were 17.71% and 5.80%, respectively.

5. Trade Accounts Receivable

	At December 31,		
	1998	1999	2000
Brazilian Air Force	70,264	64,495	46,085
Domestic customers	11,980	12,661	11,599
Foreign customers	145,588	546,369	301,587
Export financing program—PROEX(a)	15,244	27,966	33,157
	243,076	651,491	392,428
Less—current portion	203,682	274,405	347,336
Noncurrent portion	39,394	377,086	45,092

(a) Refers to receivables bought by the Company from certain clients, related to equalization of interest rate to be paid by PROEX between the 11th and 15th year after the sale of the related aircraft, which have been recorded at their present value. The interest earned is added to the balance of the account and is recorded as interest income.

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

As of December 31, 1998, 1999 and 2000, respectively, accounts receivable from the Brazilian Air Force include amounts not currently billable of R$63,312, R$61,353 and R$42,629, which relate primarily to unbilled sales values recorded using the percentage of completion method; the remaining balance refers to billed amounts for aircraft and spare parts sales.

The allowances for doubtful accounts are as follows:

	1998	1999	2000
Beginning balance	301	3,147	22,347
Exchange variation	(3)	(134)	(272)
Write-offs	(386)	(24)	—
Allowance	3,235	19,358	6,778
Ending balance	3,147	22,347	28,853

6. Recoverable Taxes

	At December 31,		
	1998	1999	2000
Value-added tax credit	13,942	34,772	12,899
Withholding and prepaid income taxes	12,300	2,266	44
Other	887	286	494
	27,129	37,324	13,437
Less—current portion	24,855	33,509	8,868
Noncurrent portion	2,274	3,815	4,569

7. Other Receivables

	At December 31,		
	1998	1999	2000
Credits with suppliers(a)	13,712	32,296	21,013
Guarantee deposits(b)	21,199	46,020	60,561
Consortium(c)	7,926	9,361	—
Advances to employees	7,302	8,081	10,736
Import duty refundable	1,927	1,354	970
Payroll tax refundable—INSS	2,113	394	400
Other	12,071	8,791	14,799
	66,250	106,297	108,479
Less—current portion	32,451	44,574	40,788
Noncurrent portion	33,799	61,723	67,691

(a) Represents aircraft parts free of charge and price discounts to be received from suppliers.

(b) Guarantee deposits represent U.S. dollar amounts deposited in an escrow account as collateral for financing of certain aircraft sold. If the guarantor of the debt (an unrelated third party) is required to pay the creditors of such financing arrangement, the guarantor has the right to the escrow funds. The deposited amounts will be released when the financing contracts mature (from 2013 to 2017) if no default by the buyers of the aircraft occurs. The interest earned on the escrow funds is added to the balance in escrow and is recorded as interest income by the Company.

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

(c) Represents light executive aircraft delivered in advance to GAPLAN Administradora de Bens S/C Ltda. (a company that administers contributions of third parties for acquisition of aircraft—also called ''consórcio'').

8. Inventories

	At December 31,		
	1998	1999	2000
Finished goods	57,117	228,759	61,873
Work-in-process	266,814	513,288	419,983
Raw materials	480,113	683,767	590,558
Used aircraft for resale	617	9,044	1,170
Supplies	978	1,459	2,279
Inventory in transit	98,334	91,655	106,790
Advances to suppliers	60,221	23,413	27,546
	964,194	1,551,385	1,210,199

Inventories, when applicable, were reduced to their replacement cost (raw materials) and net realizable value (work-in-process and finished goods), as follows:

- Allowance for reduction to market value—Inventories of work-in-process and finished goods were reduced to net realizable value after deduction for costs, taxes and selling expenses. Inventories of raw materials were reduced to market value based on the inventories' average monetarily restated cost compared with the average cost of replacement.
- Allowance for obsolescence—For items without activity for more than two years, provisions were made for possible losses on excess and obsolete suppliers and work-in-process inventories, based on management's estimate of net realizable values.

The allowances are as follows:

	1998	1999	2000
Allowance for reduction to market value:			
Beginning balance	19,187	482	—
Disposals	(18,705)	(482)	—
Ending balance	482	—	—
Allowance for obsolescence:			
Beginning balance	65,021	86,020	82,922
Allowance	19,786	—	47,947
Disposals	—	(8,815)	(14,344)
Effect of exchange rate changes	1,213	5,717	(2,892)
Ending balance	86,020	82,922	113,633
	86,502	82,922	113,633

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

9. Investments

a. Balances

	At December 31, 1998	1999	2000
Associated companies:			
AM-X International Ltd.	72	72	—
Expressprop LLC. (a)	5,561	6,570	8,024
	5,633	6,642	8,024
Others	158	190	205
	5,791	6,832	8,229

(a) Embraer owns 25% of the capital stock of this company.

b. Relevant information on consolidated subsidiaries

	Equity Participation (%)	1998 Shareholders' Equity (deficit)	1998 Net Income (loss)	1999 Shareholders' Equity (deficit)	1999 Net Income (loss)	2000 Shareholders' Equity (deficit)	2000 Net Income (loss)
Embraer Aircraft Corporation—EAC	100.00	61,919	4,077	81,307	4,905	86,667	5,761
Embraer Aviation International—EAI	100.00	8,040	(3,672)	9,483	912	5,754	(3,075)
Embraer Finance Ltd.—EFL	100.00	13,381	12,918	2,604	(13,887)	29,367	26,566
Indústria Aeronáutica Neiva S.A.—NEIVA	100.00	17,229	251	15,873	(352)	15,860	(298)
Embraer Services Inc.—ESI	100.00	4,905	4,742	11,419	5,374	15,298	3,946
Órbita Sistemas Aeroespaciais S.A.(i)	100.00	(511)	(18)	(515)	(5)	—	—
Trumpeter Inc.	100.00	5,561	57	6,376	(476)	7,728	1,389
ELEB—Embraer Liebherr Equipamentos do Brasil S.A.(i)	59.995	—	—	36,936	(154)	50,996	28,557
Embraer Aviation Europe SAS—EAE	100.00	—	—	—	—	38	—
Embraer Australia PTY Ltd.—EAL	100.00	—	—	—	—	3,752	(13)
Embraer Credit Ltd.—ECL	100.00	—	—	—	—	(1,070)	(1,070)
Embraer Europe SARL—EES	100.00	—	—	—	—	15	—

(i) The entities were merged on November 1, 2000.

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

c. Transactions With Unconsolidated Related Parties

	At December 31,		
	1998	1999	2000
Brazilian Air Force:			
Current—			
Accounts receivable	70,264	64,495	46,085
Suppliers	29	—	—
Customers' advances	31,282	44,365	35,486
Accounts payable	16,488	6,315	6,269
Noncurrent—			
Customers' advances	30,654	—	—
Income (Expenses)—			
Sales	195,601	233,607	129,835
Recovery of cost	(788)	(631)	—
Bozano Group:			
Current—			
Short-term investments	19.613	36,556	—
Other receivables	135	—	—
Loans	8,127	—	—
Interest income (expenses)—			
Temporary cash investments	3,534	1,698	367
Interest and commissions on loans	(2,363)	(72)	—

The Company has engaged in a number of transactions with the Brazilian Air Force and the Bozano Group as shown above. The Company does not engage in transactions or arrangements with any of its affiliates on a basis or terms less favorable to the Company than would be obtained at the time from an unaffiliated third party in arm's-length transactions or other arm's-length arrangements.

The Brazilian Government, principally through the Brazilian Air Force, has participated in the development of the Company and plays a key role as:

- A source for funded research and development through technology development institutions such as FINEP (Financiadora de Estudos e Projetos, a Brazilian Government financing agency) and the BNDES (National Economic and Social Development Bank).
- An export support agency through the BNDES.

The Company maintains credit facilities with the BNDES and FINEP of which R$127.8 million and R$26.1 million principal amount, respectively, was outstanding at December 31, 2000. In addition, as described in Note 13.d., the Company renegotiated reductions in the interest rates on loans from the BNDES. As described in Note 19, in February and March 1999, the Company sold a total of 83,330 debentures with the face amount of R$150.0 million, principally to BNDESPAR (BNDES Participações S.A.—BNDESPAR), a wholly-owned subsidiary of BNDES.

(Amounts in thousands of constant Brazilian *reais* as of March 31, 2001, unless otherwise indicated)

10. Property, Plant and Equipment

	Annual depreciation rate (%)	At December 31, 1998			1999			2000		
		Cost	Depreciation	Net	Cost	Depreciation	Net	Cost	Depreciation	Net
Land		23,446	—	23,446	23,431	—	23,431	26,103	—	26,103
Buildings and land improvements	2.08 to 10.00	348,728	132,278	216,450	359,381	139,772	219,609	374,053	153,375	220,678
Installations	3.23 to 10.00	198,896	164,217	34,679	202,784	172,618	30,166	229,199	182,746	46,453
Machinery and equipment	5.88 to 10.00	343,472	237,803	105,669	362,555	251,366	111,189	394,854	271,283	123,571
Furniture and fixtures	10.00 to 20.00	23,009	20,598	2,411	24,969	20,547	4,422	29,235	21,288	7,947
Vehicles	9.09 to 20.00	8,336	6,888	1,448	9,341	6,938	2,403	9,894	6,849	3,045
Aircraft	25.00	51,374	10,327	41,047	78,007	20,602	57,405	133,450	28,095	105,355
Computers and peripherals	20.00 to 25.00	51,060	38,899	12,161	65,225	43,749	21,476	83,438	50,905	32,533
Others	20.00	11,615	2,616	8,999	20,878	5,203	15,675	50,296	10,166	40,130
Construction in progress		14,500	—	14,500	35,993	—	35,993	68,108	—	68,108
		1,074,436	613,626	460,810	1,182,564	660,795	521,769	1,398,630	724,707	673,923

On December 30, 1988 and April 30, 1991, the Company recorded revaluations of its operating assets. The remaining balance of these revaluations at December 31, 1998, 1999 and 2000 amounted to R$240,099, R$222,251 and R$208,001, respectively. The corresponding revaluation reserves were used to increase capital and, except for the portion related to real estate, were included in the computation of taxable income for income tax purposes. The depreciation rates of the revalued assets were determined based on the revised estimated useful lives of these assets, in accordance with the independent appraisal reports.

11. Deferred Charges

	At December 31, 1998			1999			2000		
	Cost	Amortization	Net	Cost	Amortization	Net	Cost	Amortization	Net
ERJ 135/140/145(a)	608,747	129,653	479,094	641,100	257,334	383,766	684,661	413,014	271,647
ERJ 170/190	—	—	—	2,771	—	2,771	67,580	—	67,580
EMB 120 Brasília	361,892	303,422	58,470	311,619	309,567	2,052	311,619	309,567	2,052
S-92—Sikorsky—Components	19,788	—	19,788	22,319	—	22,319	24,283	—	24,283
Others	20,447	11,412	9,035	8,485	7,150	1,335	9,763	8,315	1,448
	1,010,874	444,487	566,387	986,294	574,051	412,243	1,097,906	730,896	367,010

(a) Includes research and development costs for the Legacy, the Company's line of corporate jets.

Deferred charges include the compensation of engineers assigned to the development of each new aircraft, support services, certain production overhead, tooling, and direct labor and materials to construct a prototype of the aircraft or relevant components. Also included are the costs of testing the prototype and subsequent design changes.

The amortization of deferred charges is computed based on the estimated number of aircraft to be produced, for each project, starting when benefits begin to be generated, and is allocated to production costs.

For cancelled projects, or those for which full realization is considered unlikely, the deferred charges are written off or reduced to estimated net realizable value.

ERJ 145

This 50-seat regional jet aircraft 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 in China in November 2000. This aircraft is being operated by regional commercial airlines in Brazil, the United States, Europe and China. As of December 31, 2000, the Company had delivered 288 ERJ 145s, and had 263 firm orders for this aircraft including two firm orders from the defense market. A modified platform of the ERJ 145 is in the development process for use in the SIVAM Program (EMB 145 AEW&C—an Airborne Early Warning and Control aircraft and EMB 145 RS—a Remote Sensing aircraft). As of December 31, 2000 the Company had 12 firm orders for such aircraft.

ERJ 140

This is a new 44-seat regional jet aircraft. Over 96% of this aircraft's parts are also used in the ERJ 145 and ERJ 135 models. The ERJ 140 is expected to be available for the market in 2001. As of December 31, 2000, the Company had a backlog of 133 firm orders for this aircraft.

ERJ 135

This 37-seat regional jet aircraft received certification on July 16, 1999, from Federal Aviation Administration—FAA to operate in the United States, and the certification by the Joint Aviation Authorities—JAA to operate in Europe was in October 1999. As of December 31, 2000, the Company had delivered 64 aircraft, of which two were for the corporate aviation market and one for the Greek government. The Company has 87 firm orders for this aircraft, including two firm orders from the defense market.

In July 2000, the Company introduced its latest product: the Legacy. This aircraft is a derivative of the ERJ 135 and will be offered in two versions: executive and corporate shuttle. As of December 31, 2000, the Company had a backlog of 29 firm orders for this aircraft.

ERJ 170 and ERJ 190

The Company is developing a new family of regional jets with capacities for 70, 98 and 108 passengers, the ERJ 170, ERJ 190-100 and ERJ 190-200, respectively. As of December 31, 2000, the Company had 120 firm orders for these regional jets.

EMB 120 Brasília

This 30-seat regional turboprop aircraft received certification to operate in the United States and Brazil in the second semester of 1985. As of December 31, 2000, the Company had delivered 350 EMB 120 Brasília, including five deliveries for the Brazilian Air Force, and had two firm orders for this aircraft.

The EMB 120 Brasília project was being amortized based on the expected original total number of aircraft to be sold. Due to a reduction in potential sales for this aircraft, in 1997 and 1999 management wrote off R$132,722 and R$50,273, respectively, of deferred charges related to this aircraft model, leaving R$2,052 for the amortization of two aircraft which are in the Company's backlog.

S-92—Sikorsky Components

The Company is in the process of development and production of fuel tank structures and fuel systems and landing gear of the helicopter model S-92 Helibus, to be produced by Sikorsky Corporation (USA).

The research and development costs per aircraft, as of December 31, 2000, as well as the backlog are presented below:

	EMB 120	ERJ(a) 135/140/145	ERJ 170/190
	In thousands of reais except for quantities in units		
Deferred costs	311,619	684,661	67,580
Accumulated amortization	(309,567)	(413,014)	—
Net	2,052	271,647	67,580
Quantity of aircraft projected for the program at December 31, 2000	352	960	650
Quantity of aircraft at December 31, 2000:			
Delivered	350	352	—
Firm orders	2	512	120
Options with exercisable date in (not audited):			
2001	—	126	15
2002	—	77	10
2003	—	57	10
2004	—	78	10
Thereafter	—	101	160
Total options	—	439	205
Total	352	1,303	325

(a) The quantity of aircraft includes the Legacy backlog but does not include the EMB 145 AEW&C and EMB 145 RS backlog.

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

12. Suppliers

	At December 31,		
	1998	1999	2000
Foreign suppliers:			
Risk-sharing partners(a)	91,478	129,635	192,015
Others	236,350	257,438	300,860
Local suppliers	11,659	12,391	35,701
	339,487	399,464	528,576
Less—current portion	333,449	399,464	528,576
Long-term portion	6,038	—	—

(a) These risk-sharing partners develop and manufacture significant portions of the Company's aircraft, including the engines, hydraulic components, avionics, wings, interior and parts of the fuselage and tail. The Company's contracts with risk-sharing partners are long-term in nature and include the following principal terms:

- Deferral of payments for components and systems for a negotiated period of time after the delivery of such components and systems.
- Minimum delivery requirement for a certain number of ERJ 145 aircraft ranging from 250 to 400 aircraft depending on the contract. In the event the Company fails to deliver this minimum number of aircraft, the Company would have to reimburse proportionally the suppliers for their tooling and development cost. Considering the number of aircraft under firm orders and deliveries already made, management believes this requirement will be met.

Once risk-sharing partners have been selected and the 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 the Company susceptible to the performance, quality and financial condition of these risk-sharing partners.

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

13. Loans

a. Composition

	Currency	Interest Rate—%	At December 31, 1998	1999	2000
Foreign currency:					
FINAMEX—export financing	U.S. dollar	LIBOR + spread (1.70 to 2.00)	432,372	308,172	—
Materials acquisition	U.S. dollar/Japanese Yen	1.88 to LIBOR + 0.75	292,604	608,116	356,345
Advances on export sales contracts	U.S. dollar	6.00 to 7.68	127,493	94,192	234,813
Project development	Indexed to the U.S. dollar	LIBOR + 3.00	44,390	46,714	38,519
Working capital	U.S. dollar/ French francs	7.00 to 8.00	15,471	65,077	133,697
Property and equipment acquisition	U.S. dollar	10.15 to 11.80	1,659	967	25,224
			913,989	1,123,238	788,598
Local currency:					
Project development		TJLP (long-term interest rate) plus 3.00 to 5.50	178,224	145,995	115,961
Property and equipment acquisition		TJLP (long-term interest rate) plus 3.30 to 4.40	—	—	2,389
			178,224	145,995	118,350
Total			1,092,213	1,269,233	906,948
Less—current maturities			891,477	1,108,536	726,922
Long-term portion			200,736	160,697	180,026

b. Long-term Maturities

Year	At December 31, 1998	1999	2000
2000	32,113	—	—
2001	37,288	34,704	—
2002	36,477	34,704	90,762
2003	36,477	34,701	34,558
2004	36,477	32,232	31,712
2005 to 2006	21,904	24,356	22,994
	200,736	160,697	180,026

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

c. Currency Analysis

Total debt was denominated in the following currencies:

	Exchange rate at December 31, 2000 (units of one Brazilian real)	At December 31, 1998	1999	2000
Brazilian reais	1.0000	178,224	145,995	118,350
U.S. dollars	1.9554	898,518	1,087,413	669,764
French francs	0.280771	15,471	35,825	80,617
Japanese Yen	0.017082	—	—	38,217
		1,092,213	1,269,233	906,948

The exchange rates variations in relation to the Brazilian real were as follows:

	At December 31, 1998	1999	2000
U.S. dollars	8.27%	48.01%	9.30%
French francs	15.46%	28.03%	1.93%
Japanese Yen	—	62.46%	0.98%

Total debt denominated in Brazilian *reais* is subject to monetary restatement based on the variance of the Brazilian long-term interest rate—TJLP.

The annualized variations of this index were as follows:

	At December 31, 1998	1999	2000
Brazilian long-term interest rate—TJLP (%)	11.65	13.22	10.75

The Company and its subsidiaries partially hedge their foreign currency liabilities. In the opinion of management, the Company's exposure to devaluation of the Brazilian real against other currencies is mitigated by the substantial amount of sales revenues which are denominated in U.S. dollars.

d. Interest and Guarantees

The foreign currency financing outstanding at December 31, 2000 was subject to weighted average annual interest of 7.76% (8.65% and 8.33% at December 31, 1998 and 1999, respectively) plus exchange variation; for local currency financing outstanding at December 31, 2000, the weighted average annual interest rate was 13.46% (14.58% and 15.87% at December 31, 1998 and 1999, respectively).

The Company renegotiated reductions in the spreads on loans from the BNDES (National Economic and Social Development Bank) from 4.5% for the FINEM line (a line of credit made available by BNDES to Brazilian corporations) and 6.5% for the import line to 3.0% and 5.5% per year, respectively, and on the collateral amount, effective January 1, 1997. Because of these decreases, the Company pays fees to the BNDES of 0.35% of the sales price of each ERJ 145 aircraft sold, limited to 420 aircraft sold between January 1, 1997 and December 31, 2005.

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

Collateral for part of these loans includes the pledge of property, machinery, equipment and inventories, in the amount of R$400,561. Of this amount, R$91,464 is related to a second mortgage on real estate.

14. Customers' Advances

	At December 31,		
	1998	1999	2000
Local currency	43,414	73,714	31,360
Foreign currency	349,896	590,541	711,234
	393,310	664,255	742,594
Less—current portion	235,675	439,576	581,554
Long-term portion	157,635	224,679	161,040

The foreign currency advances are denominated in U.S. dollars but are presented in reais in the above chart. Segregation between current and long-term portions is based on contractual terms to deliver the related aircraft.

15. Accounts Payable

	At December 31,		
	1998	1999	2000
Brazilian Air Force(a)	16,488	6,315	6,269
Insurance	3,433	4,820	5,013
Joint responsibilities(b)	4,539	2,888	500
Commercial rebates(c)	4,160	14,042	69,666
Labor contingencies	6,627	1,547	—
Pension fund contributions	4,730	1,099	948
Accrued premium on class "B" shares(d)	10,253	—	—
Grant for investment from suppliers(e)	3,237	42,392	280,956
Customers credits(f)	—	21,353	15,399
Other	10,553	7,537	34,101
	64,020	101,993	412,852
Less—current portion	47,899	58,709	128,288
Long-term portion	16,121	43,284	284,564

(a) Amounts payable to the Brazilian Air Force represent royalties on the EMB 120 Brasília program and materials related to the delivery of AM-X aircraft.

(b) Joint responsibilities represent trade receivables discounted with recourse which customers did not pay when due and creditors have not yet exercised their rights of recourse.

(c) Commercial rebates refer to credits of spare parts given to customers.

(d) Accrued premium on class "B" shares was equivalent to the accumulated change in the National Consumer Price Index—INPC index plus 16% per year.

(e) Grant for investment from suppliers represents funds and materials received from suppliers in the development of the ERJ 170/190 programs. The liabilities are waived when certain requirements are met.

(f) Refers to amounts accrued to compensate customers for certain financing costs.

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

16. Taxes and Social Charges Payable

a. Composition

	At December 31,		
	1998	1999	2000
Refinanced taxes:			
INSS (social charges on payroll)	74,775	65,165	57,415
FNDE (education tax on payroll)	6,433	6,318	6,537
ICMS (State VAT)	3,466	1,720	—
ASEP (tax on sales)	9	—	—
COFINS (tax on sales)	14	—	—
	84,697	73,203	63,952
Current taxes	13,379	18,600	25,548
Contingent tax and social charges(a)	6,768	51,697	115,583
	104,844	143,500	205,083
Less—current maturities	32,905	83,149	151,806
Long-term portion	71,939	60,351	53,277

(a) The Company is challenging in court the constitutionality of the nature and modifications in rates and the increase in the calculation base of certain taxes and social charges in order to obtain writs of mandamus or injunctions to avoid payments or recover past payments. As of December 31, 2000, the Company had obtained preliminary injunctions for not paying or recovering past payments of taxes and social charges in the total amount of R$115,583, monetarily restated. The monetary restatement is being charged to financial expenses. The taxes and social charges are as follows:

- As from January 1, 1999, the tax bases of PIS and COFINS (taxes on sales) have been expanded. The Company obtained a preliminary injunction to prevent payment of the related tax and has accrued the amount of R$50,771.
- Brazilian companies are required to pay the Government a tax called FNDE (education tax on payroll) at a rate of 2.5% of wages. In June 1999, the Company obtained a preliminary injunction to recover past payments at the rate of 2.5% from October 1988 to December 1996 and offset it against future payments. The amount of the tax offset remains accrued as a liability by the Company in the amount of R$21,666.
- The Company is required to pay the Government a tax called SAT (Workers Compensation Insurance) at a rate of 3% of wages. In December 1998, the Company obtained a preliminary injunction to reduce the tax rate payment from 3% to 1%, and the difference has been accrued in the amount of R$12,800.
- In April 1999, the Company obtained a writ of mandamus to offset social charges payments (INSS—National Institute of Social Security), made in August, September and October 1989, against future payments due to rate increase from 10% to 20%, which has been considered unconstitutional. The amount of R$30,346 is recorded as an accrued liability.

The outstanding balances of refinanced taxes as of December 31, 2000 are subject to monthly interest of 1%, which is added to principal.

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

b. Maturities of Long-term Portion

Year	At December 31, 1998	1999	2000
2000	7,508	—	—
2001	5,128	4,803	—
2002	5,128	4,803	4,599
2003	5,128	4,803	4,599
2004	5,128	4,803	4,599
2005	5,128	4,803	4,599
2006 to 2013	38,791	36,336	34,881
	71,939	60,351	53,277

17. Accrued Liabilities

	At December 31, 1998	1999	2000
Contingencies(a)	65,117	42,692	29,731
Accrued vacations	34,651	39,984	59,548
Accrued pension benefit cost	3,448	4,109	5,245
Employee profit sharing	15,803	29,014	52,681
Product warranties	19,917	46,369	91,642
Product improvement(b)	—	—	84,980
Deferred State VAT and taxes on sales	3,092	5,090	5,346
Provisions for losses on contracts	18,682	9,108	23,186
Accrued Trade Concession(c)	—	—	27,112
Other	2,474	1,490	12,899
	163,184	177,856	392,370
Less—current portion	80,653	135,171	363,889
Long-term portion	82,531	42,685	28,481

(a) The Company is subject to lawsuits in the ordinary course of business. The accrual for contingencies is recorded based on the opinion of legal counsel, with regard to the expected outcome of all pending lawsuits. The accrued amounts are based on expected success in certain current lawsuits and settlement negotiations in progress.

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

The composition of accrual for contingencies as of December 31, 2000 is as follows:

	R$ million
Labor contingencies related to:(1)	
Retroactive wage increase(i)	1.4
Individual labor claims with regard to overtime and other matters(ii)	8.1
1992 salary adjustments(iii)	6.0
CBA-123 program(2)	0.3
Import tax(3)	1.2
FUNDAF(4)	9.0
Tax contingencies(5)	3.7
	29.7

(1) The labor lawsuits are brought by unions on behalf of employees or by individuals, as described below:

(i) This lawsuit was filed in June 1991 on behalf of all employees employed at the Company as of November 1990. The lawsuit seeks to apply retroactively to November and December 1990 a wage increase implemented by the Company in January and February 1991 pursuant to an agreement between the Company and a labor union. The total exposure for payment of the retroactive salaries, including interest accrued thereon, amounted to R$5.7 million as of December 31, 2000. The Company lost this suit in 1996 and from that time the regional labor court in Brazil began analyzing the amount to be paid to the employees. In July 1997, the Company settled with 95% of its current employees, paying an aggregate of R$18.9 million. The Company settled with 3,176 out of 4,244 former employees, paying an amount of R$8.2 million and R$12.3 million during 1999 and 2000, respectively. The Company is currently attempting to settle this case with the employees who have not yet settled.

(ii) The Company is a defendant in approximately 407 lawsuits related to individual labor claims with respect to overtime, readmission and additional amounts, in many of which the Company expects to receive favorable judgments. The total exposure for payment in connection with these individual claims amounts to R$9.7 million. The Company settled with several employees and paid others based on adjudicated amounts in the total amount of R$4.4 million and R$10.3 million during 1999 and 2000, respectively.

(iii) This lawsuit was filed by 1,219 employees and by the union on behalf of certain employees employed in 1992 with respect to salary adjustments for that year. The Company lost this suit and was ordered to adjust salaries, in accordance with a productivity index, and to refrain from dismissing certain striking workers for a period of 90 days. As of December 31, 1998, the Company had reached a settlement with approximately 90% of its employees included in the lawsuit filed by the labor union pursuant to which the Company paid approximately 30% of the amount determined in the judgment. During 1999 and 2000, the Company entered into an agreement with the labor union to end the case and paid the amounts of R$2.7 million and R$1.2 million respectively, for the remaining 10% of its employees. The total exposure for payment to current and former employees who filed suit individually amounts to R$8.5 million. The Company is currently attempting to settle this case with the employees individually.

(2) This provision refers to taxes and contractual contingencies related to the CBA-123 program, which was discontinued after the construction of three prototypes. During 1999, the Company entered into an agreement with suppliers to settle the contractual contingencies in the amount of R$1.0 million.

(3) This provision relates to import duty and VAT tax (IPI) owed on imported materials for two flight simulators, which must be exported within a certain time period to be exempt of such taxes. The materials were exported after the previously established period. The Company is currently discussing the payment terms of the assessment with the tax authorities.

(4) This provision relates to a contribution called FUNDAF (Special Fund for Development and Improvement of Fiscalization), owed to the Internal Revenue Department on customs clearance of imported materials. In October 1999, tax authorities assessed the Company, which is currently challenging the legality of such contribution.

(5) This provision refers to a deficiency notice from the Internal Revenue Department for social contributions which are being challenged.

Additionally, the Workers Union initiated a lawsuit against the Company in October 1992 on behalf of 7,283 current and former employees, which is currently awaiting a ruling by the Superior Labor Court, Brazil's highest appellate court for labor disputes. The plaintiffs are seeking payment of salary differences based on existing agreements between the labor unions and the Federação das Indústrias do Estado de São Paulo, or the Industry Federation of the State of São Paulo, also known as FIESP. The total exposure for payment of retroactive salaries, was R$60.8 million on December 31, 2000. At December 31, 2000, the Company had not accrued any amounts for this lawsuit. Management believes, based on advice of Brazilian counsel, that this lawsuit will not result in a decision adverse to the Company. Final judgment is not expected to occur before the second half of 2001.

On January 9, 1997, an EMB 120 Brasília aircraft operated by Comair, a regional U.S. carrier, crashed outside of the Detroit Metropolitan Airport, in an accident with fatalities. The preliminary investigations by the U.S. aviation authorities have concluded that the Company was not responsible for the accident. Comair's insurers have reached final settlements for compensation with respect to 24 passengers and 3 crewmembers. Only one action, in the name of two passengers, is still awaiting a final ruling. Management believes that any remaining liabilities or expenses related to this case, if adjudicated payable, will be covered by insurance.

In addition, the Company is involved in other legal proceedings, all of which are in the ordinary course of business. In the opinion of management, none of these proceedings is expected to have a material adverse effect on the financial condition or results of operations of the Company.

(b) This refers to amounts accrued to implement improvements in aircraft sold to maintain achievement of contractual performance indices.

(c) Accrued trade concession represents expenses in connection with the obligation to provide technical assistance and training of mechanic and airplane crew of customers.

18. Dividends

In conformity with the Company's bylaws, shareholders are entitled to minimum dividends equivalent to 25% of annual net income computed in accordance with the accounting principles emanating from Brazilian corporate law. The Company's preferred shares do not have voting rights but have priority in capital redemption and, in accordance with present corporate law, have the right to dividends in an amount 10% greater than those payable to the common shares.

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

The Company has elected to pay interest on shareholders' capital, calculated on a quarterly basis in accordance with article 9 of Law No. 9,249/95 based on the TJLP, for deductibility purposes in computing income and social contribution taxes, and charged directly to shareholders' equity for reporting purposes, in compliance with CVM Instruction No. 207/96.

The dividends for 1998, 1999 and 2000 were calculated as follows:

	1998	1999	2000
Unconsolidated net income of the Company as per corporate law	191,253	482,294	676,867
Less—legal reserves	(9,561)	(24,116)	(33,844)
Adjusted net income per corporate law	181,692	458,178	643,023
Minimum dividend (25%)	45,423	114,545	160,756
Additional dividends	28,576	23,205	131,067
Dividends proposed	73,999	137,750	291,823
Withholding income tax on interest on capital	—	—	(15,318)
Interim payments	(28,548)	(41,037)	(138,643)
Dividends payable	45,451	96,713	137,862
Unclaimed dividends from prior years	26	74	11,991
Total dividends payable	45,477	96,787	149,853

The interim payment in 2000 is composed as follows:

		Dividends per share	
Approval date	Amounts	Common	Preferred
		(in Brazilian reais)	
March 24, 2000—Interest on Capital	16,930	0.03285	0.03614
June 16, 2000—Interest on Capital	17,129	0.03331	0.03664
July 6, 2000—Dividends	80,701	0.15693	0.17262
September 22, 2000—Interest on Capital	23,883	0.04164	0.04578
Interim payment	138,643		

Amounts proposed for fourth quarter are as follows:

		Dividends per share	
Approval date	Amounts	Common	Preferred
		(in Brazilian reais)	
December 15, 2000—Interest on Capital	28,866	0.05033	0.05537
December 31, 2000—Dividends	108,996	0.19006	0.20906
Total dividends proposed for the fourth quarter	137,862		

Interest on capital is shown above net of withholding income tax at the official rate of 15%. Shareholders that are exempt from the withholding income tax will receive the gross amount of interest on capital.

Dividends are calculated on the Company's adjusted net income for the year, which is determined using the equity method of accounting for subsidiaries. Additionally, from 1996 on, due to the cessation of the price-level restatement adjustments in the corporate law method financial statements, the effect of those adjustments on consolidated net income in the accompanying financial statements must be eliminated to arrive at distributable income on a corporate law basis.

19. Debentures

The Extraordinary Shareholders' Meeting, on December 11, 1998, approved the issuance of the fourth series of debentures, coupled with 100 detachable subscription warrants per debenture.

Each subscription warrant entitles its holders to purchase 10 preferred shares, or, in certain circumstances, 10 common shares at any time after June 6, 2000 or 90 days after any public offering of shares, whichever occurs first. If and when the subscription warrants are exercised, the issue price will be R$1.83 per share, as adjusted by the Brazilian long-term interest rate (TJLP) from July 1, 1998. The issue price was higher than the market price of the shares at the date of issuance of the debentures.

The additional issuance, which was subscribed and paid for in February and March 1999, consists of 83,330 debentures, with a face value of R$1,800.00 each, in the total amount of R$150.0 million, to be repaid in five installments as follows: 10% on July 1, 2001, 10% on July 1, 2002, 60% on July 1, 2003, 10% on July 1, 2004 and 10% on July 1, 2005.

The face value is restated based on the Brazilian long-term interest rate (TJLP) from the issue date to the maturity date plus 2% per year and an additional interest of 5% per year, calculated on a daily "pro rata" basis on the restated face value. The Company will not pay the premium if any of the circumstances described below occurs:

- The subscription warrants are traded by the debenture holders separately from the debentures.
- The subscription warrants are exercised.
- Market conditions allow the negotiation of shares equal to or greater than a preestablished price.

On February 18, 2000, 833,500 subscription warrants were exercised for the issuance of 8,335,000 preferred shares, paid with 8,335 debentures which are held in treasury.

The issue price of the shares was R$2.4228 per share, totaling R$20,194. Of this amount, 30% was allocated to capital reserves and the balance to capital, as stipulated in item 4.2.11 of clause 4 of the deed of the 4th issue of debentures.

On June 30, 2000, interest was paid to the debenture holders of the 4th issue for the second capitalization period in the amount of R$3,783.

On July 27, 2000, BNDES Participações S.A.—BNDESPAR, which is the sole holder of the debentures, exercised 105,700 subscription warrants, with the issuance of 1,057,000 preferred shares. The issue price of the shares was R$2.4928 per share, totaling R$2,635, 30% of which was allocated to capital reserves and the balance to capital, as required under the debenture indenture agreement.

At December 31, 2000, the monetarily restated value of these outstanding debentures was R$180,200, and accrued interest was R$1,823. The premium was not accrued at December 31, 2000, since the share negotiation price (R$18.46) was above the preestablished price (R$3.47).

20. Shareholders' Equity

a. Capital

At December 31, 2000 the Company's statutory fully paid-in capital stock is represented as follows:

Classes of shares	Quantity
Registered common shares	242,544,447
Special registered common share	1
Preferred shares	300,865,426
	543,409,874

a.1. Special Registered Common Share—"Golden Share"

A special registered common share ("golden share") is held by the Brazilian Government. As the holder of the golden share, the Brazilian Government is entitled to the same voting rights as the other holders of common shares. In addition, the golden share carries veto power over the following corporate actions relating to the Company:

- Change of corporate purpose.
- Change of name.
- Alteration and use of logo.
- Creation or alteration of defense programs (whether the Brazilian Government participates or not in such programs).
- Acceptance, for defense programs, of the technological qualifications of third parties.
- Interruptions in the supply of maintenance and spare parts for defense aircraft.
- Change of control.
- 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 attributed to the golden share.

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

a.2. Composition of Shareholders

	Number				%	
	Common		Preferred			
Shareholders	1999	2000	1999	2000	1999	2000
Caixa de Previdência dos Funcionários do Banco do Brasil—PREVI	59,243,379	59,243,379	70,826,935	59,356,935	27.03	21.83
Fundação SISTEL de Seguridade Social	48,508,890	48,508,890	37,678,904	14,639,674	17.91	11.62
Cia. Bozano	48,509,221	48,509,220	—	14,260,613	10.08	11.55
Bozano Holdings, Ltd.	—	—	21,072,043	44,429,611	4.38	8.18
Kol Fund. Inv. em Ações(a)	—	1,066,177	51,865,181	17,702,057	10.78	3.45
Dassault Aviation	13,744,186	13,744,186	—	—	2.86	2.53
Thomson CSF	13,744,186	13,744,186	—	—	2.86	2.53
EADS	13,744,186	13,744,186	—	—	2.86	2.53
SNECMA	7,276,332	7,276,332	—	—	1.51	1.34
Federal Government	3,514,388	3,514,388	—	—	0.73	0.65
Other	34,259,680	33,193,504	57,230,363	150,476,536	19.00	33.79
	242,544,448	242,544,448	238,673,426	300,865,426	100.00	100.00

(a) This investment fund is controlled by Fundação SISTEL de Seguridade Social.

As approved by the Company's Board of Directors on June 30 and July 20, 2000, a public issue of 52,800,000 preferred shares at a price of R$8.45 per share was made, totaling R$475,350, within the authorized capital limit, in order to raise funds for the Company's investment plans.

Under the terms of article 172 of Law No. 6,404/76, of article 6, paragraph 3 of the Company's bylaws, and decisions made by the Board of Directors at the above-mentioned meetings, the Company's shareholders were not granted preference rights.

On July 26, 2000, the Company's Board of Directors ratified the capital increase from R$367,453 to R$807,277 (as per the corporate law method of accounting), composed of 242,544,448 common shares, including one special class golden share, and 299,808,426 preferred shares, totaling 542,352,874 shares without par value.

Together with the primary offering, a secondary public offering of 31,200,000 preferred shares was made. Those shares were held by Cia. Bozano, Fundação SISTEL de Seguridade Social, Caixa de Previdência dos Funcionários do Banco do Brasil—PREVI and BNDESPAR.

The primary and secondary offerings were made in Brazil and abroad, within the context of a global offering. The global offering was comprised of preferred shares in Brazil and an offer of preferred shares represented by American Depositary Shares (''ADSs'') abroad. Each ADS is represented by four preferred shares.

The shares issued and sold under the global offering have the same rights as stipulated in the Company's bylaws, but are only entitled to receive dividends from income earned starting July 1, 2000.

The number of preferred shares included in the secondary offering was increased by 12,600,000 preferred shares, through a purchase option extended by the selling shareholders to the coordinators of the global offering, specifically to satisfy excess demand for the global offering.

In connection with the global offering, BNDESPAR exercised its rights on 105,700 subscription warrants, and the Company issued 1,057,000 preferred shares in the total amount of R$2,635.

After the exercise of the subscription warrants, the Company's statutory capital increased from R$807,277 to R$808,984, divided into 543,409,874 shares without par value, consisting of 242,544,448 common shares, including one special golden share, and 300,865,426 preferred shares.

b. Redemption of Class "B" Shares

As approved at the Special Shareholders' Meeting on April 30, 1999, and in order to comply with the conditions established for the class "B" preferred shares, all 3,275,365 outstanding shares of this class were redeemed on May 11, 1999, without a capital reduction.

c. Legal Reserve

Brazilian corporations are required to allocate 5% of annual net income to a legal reserve until that reserve equals 20% of paid-up share capital, or that reserve plus capital reserves equals 30% of nominal paid-up share capital; thereafter, allocations to this reserve are voluntary. This reserve can be used only to increase share capital or to offset accumulated losses.

d. Reverse Split

At the Shareholders' Meeting held on April 30, 1999, a reverse stock split was approved at the ratio of 100 to 1; as a result, shareholders now hold one new common or preferred share for each one hundred shares of the same type previously held. After the reverse split, the Company's shares are negotiated on the stock exchanges at unit prices.

The effect of the reverse stock split is reflected retroactively for all of the periods presented in the accompanying financial statements.

Due to the fact that it is not traded on any exchange, the foregoing transaction did not affect the golden share.

The fractional shares from the exchange of common and preferred shares were sold on the São Paulo Stock Exchange on September 28 and 29, 1999, and the credits are available at the Company, in the name of the shareholders.

e. Stock Options

The Special Shareholders' Meeting, held on April 17, 1998, approved a stock option plan for management and employees of the Company and its subsidiaries, subject to restrictions based on continuous employment with the Company or its subsidiaries for at least two years. The Plan Administration Committee, which was appointed at the Board of Directors' meeting held on April 17, 1998, is responsible for defining the rules and managing the Plan.

Under the terms of the plan, options for 25,000,000 preferred shares are authorized to be granted. At the end of the third and fourth years, subsequent to the grant, the employees will have the right to exercise 30% of the options so granted, respectively, and the remaining 40% is exercisable at the end of the fifth year, if still employed by the Company on each date. As of December 31, 2000, the Administration Committee had made six grants, equivalent to 358 lots of 50,000 shares each, totaling 17,900,000 preferred shares, net of 50,000 shares of which were forfeited, as the beneficiaries are no longer employees of the Company. Of this total, 25.2%, equivalent to 4,515,000 preferred shares, may be exercised starting May 31, 2001, and 3.4%, equivalent to 600,000 preferred shares, starting November 30, 2001.

Options are granted with an exercise price equal to the weighted average price of the Company's preferred shares traded on the São Paulo Stock Exchange in the 60 trading days prior to the granting date, increased or decreased up to 30%, as defined by the Plan Administration Committee. Such percentage is deemed to offset unusual fluctuations in the market price during this 60-day period.

The plan terminates five years after the first grant. No amounts have been charged to expense for the options.

f. Strategic Partnership

On October 25, 1999, Embraer announced a strategic alliance with European Aeronautic Defense and Space Company N.V., Dassault Aviation, Société Nationale d'Étude et de Construction de Moteurs d'Aviation and Thomson-CSF, European aerospace and defense companies (the ''European Aerospace and Defense Group'') as a result of a transaction developed by one of the controlling shareholders, the Bozano Group, with approval and support of the other controlling shareholders, PREVI and SISTEL. As a result, the European Aerospace and Defense Group acquired 48,508,890 common shares in the Company, representing 20% of the total common shares, not linked to any shareholder agreement nor tied to the Company's controlling shareholder group. Consequently, the ownership control and the Company's top decision-making process remain exclusively in the hands of the current majority shareholders.

The European Aerospace and Defense Group made a public offering for the acquisition of 36,000,000 common shares and a private purchase of the remaining shares was made. The conditions and terms were published in the *Gazeta Mercantil* (Brazil's principal business newspaper) on October 26 and 27, 1999.

g. Net Income Allocation

Management will propose to the Annual Shareholders' Meeting for 2001 the retention of net income for the year, after allocation to the legal reserve and the dividend distribution, amounting to R$145,012, as a reserve for investments and working capital.

21. Financial Instruments

Estimated fair values of the Company's financial assets and liabilities have been determined using available market information and appropriate valuation methodologies. However, considerable judgment was required in interpreting market data to produce the estimated fair values. Accordingly, the estimates presented below are not necessarily indicative of the amounts that could be realized in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair values.

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

As of December 31, 2000, the Company had the following principal financial instruments:

(a) Cash, Cash Equivalents, Trade Accounts Receivable, Other Current Assets, Accounts Payable and Accrued Expenses—The carrying value of cash, cash equivalents, trade accounts receivable, other current assets, accounts payable and accrued expenses approximate their fair value.

(b) Investments—Consist mainly of subsidiaries and affiliates accounted for under the equity method or at restated cost and which have strategic interest for the Company's operations; market value considerations are not applicable.

(c) Loans—Subject to interest at usual market rates, as described in Note 13. The estimated fair value was calculated based on present value of future cash outflow using interest rates that are currently available to the Company for issuance of debt with similar terms and maturities. The estimated fair value for the loans, including short term installments, is as follow:

	At December 31, 2000
Book Value	906,948
Fair Value	865,957

(d) Financed Taxes—The conditions are similar to the usual terms for financed taxes and there are no material differences related to interest rates applicable to loans. The estimate fair value was calculated based on present value of future cash outflow using interest rates that are currently available to the Company for issuance of debt with similar terms and maturities. The estimated fair value for the financed taxes, including short-term installments, is as follow:

	At December 31, 2000
Book Value	63,952
Fair Value	21,172

(e) Derivatives—The derivative financial instruments held by the Company at December 31, 2000 consist of interest rates swaps and foreign currency forward contracts. The Company does not trade in derivatives for speculation purposes.

The interest rate swaps, which are associated with U.S. dollar-denominated debt, are designed to partially cover the future maturity of the U.S. dollar-denominated debt based on LIBOR. As of December 31, 2000, the notional amount of the interest rates swaps is US$65 million with an average fixed interest rate of 6.1% per annum, representing 35.0% of the total debt based on LIBOR. The swaps are recorded at their spot market value at the balance sheet date and unrealized gains or losses are recognized in the income statement.

Foreign currency option contracts were entered into to reduce the Company's exposure to risk related to a sale contract comprising five firm orders for ERJ 135/145 regional jet, which includes an option for the purchaser to pay in Euros. As of December 31, 2000, the estimated value of the foreign currency option contract expiring in April 2001 and denominated in U.S. dollars was US$59.1 million. These foreign currency option contracts are recorded at their spot market value at the balance sheet date and unrealized losses are recognized in the income statement. Unrealized gains in the amount of R$8,229.6 as of December 31, 2000 were deferred to be recognized at exercise dates, which are approximately the same of the deliveries of the related aircraft.

Foreign currency forward contracts were also entered into to cover the future maturity of specific risk of import financing obtained in Japanese yen, converting the debt into U.S. dollars and as of December 31, 2000 the notional amount of these contracts was US$22.1 million. The foreign currency forward contracts are recorded at their spot market value at the balance sheet date and an unrealized losses of R$4,577.0 were recognized in the income statement.

22. Supplementary Retirement Plan

a. Company

On June 26, 1998, the Board of Directors approved the implementation of the Embraer Supplementary Retirement Plan, with the Company initiating its contributions on July 1, 1998.

The plan is a private, defined-contribution plan where participation is optional; it is administered by a Brazilian pension fund administrator controlled by Banco do Brasil. The Company's contributions to the plan in 1998, 1999 and 2000 were R$3,939, R$7,189 and R$6,858, respectively.

b. Subsidiaries

The Embraer Aircraft Corporation 401(k) Retirement Plan (the ''401(k) Plan'') was originally established by EAC as a profit sharing plan on January 1, 1981. On November 1, 1993, the 401(k) Plan was amended and restated to comply with the provisions of section 401(k) of the U.S. Internal Revenue Code as a defined contribution, deferred compensation plan. Employees who have attained age 21 and provided 1,000 hours of service during a year are eligible for participation. EAC's profit-sharing contributions to the 401(k) Plan are discretionary. EAC may also match a discretionary percentage of the amount contributed by the participant up to a specified dollar amount. Vesting in company matching contributions is 20% after three years of service, 40% after four years, 60% after five years, 80% after six years and 100% after seven years. EAC did not make a profit sharing contribution or a matching contribution for the years ended December 31, 1998, 1999 and 2000.

EAC also sponsors a defined benefit plan, which includes a pension plan and a post-retirement medical plan. The plans cover substantially all employees, with retirement benefits based on compensation levels and the number of years of covered service. EAC makes contributions to the plans as required to meet Internal Revenue Service funding standards. To determine the periodic pension expense and contribution to the plan the actuarial method used is the ''projected unit credit method''.

The expected costs of providing post-retirement medical benefits to an employee and the employee's beneficiaries and covered dependents are accrued during the years that the employee renders the necessary service.

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

The change in benefit obligations for the years ended December 31, 1998, 1999 and 2000 is as follows:

	Pension benefits			Post-retirement benefits		
	1998	1999	2000	1998	1999	2000
Benefit obligation—beginning of year	9,880	11,971	15,593	4,342	5,614	6,223
Service cost	1,092	1,869	2,163	402	598	595
Interest cost	599	803	1,011	308	361	453
Supplement to the plan	—	—	1,161	—	—	—
Actuarial loss (gain)	477	1,618	(741)	1,051	(184)	584
Benefits paid to participants	(77)	(668)	(461)	(489)	(166)	(166)
Benefit obligation—end of year	11,971	15,593	18,726	5,614	6,223	7,689

The change in plan assets for the years ended December 31, 1998, 1999 and 2000 is as follows:

	Pension benefits			Post-retirement benefits		
	1998	1999	2000	1998	1999	2000
Fair value of plan assets—beginning of year	5,159	6,787	8,417	2,895	2,973	3,468
Employer contributions	1,139	1,610	1,805	259	361	709
Participant contributions	6	—	—	12	13	—
Actual return on plan assets	560	688	116	296	287	47
Benefits paid to participants	(77)	(668)	(461)	(489)	(166)	(166)
Fair value of plan assets—end of year	6,787	8,417	9,877	2,973	3,468	4,058

The components of accrued benefit cost at December 31, 1998, 1999 and 2000 are as follows:

	Pension benefits			Post-retirement benefits		
	1998	1999	2000	1998	1999	2000
Funded status	(5,184)	(7,176)	(8,849)	(2,641)	(2,755)	(3,631)
Unrecognized transition obligation	393	319	245	—	—	—
Unrecognized prior service cost	(368)	(344)	764	(103)	(89)	(75)
Unrecognized net loss	3,498	5,560	5,119	957	376	1,182
Accrued benefit cost	(1,661)	(1,641)	(2,721)	(1,787)	(2,468)	(2,524)

The accrued benefit cost at December 31, 1998, 1999 and 2000 is included in accrued liabilities in the accompanying balance sheets.

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

The weighted average assumptions at December 31, 1998, 1999 and 2000 are as follows:

	Pension benefits %			Post-retirement benefits %		
	1998	1999	2000	1998	1999	2000
Average discount rate	6.00	6.50	6.50	6.25	6.75	6.50
Expected return on plan assets	7.75	7.75	7.75	7.75	7.75	7.75
Rate of compensation increase	6.00	6.00	6.00	6.00	6.00	6.00

The components of net periodic benefit cost at December 31, 1998, 1999 and 2000 are as follows:

	Pension benefits			Post-retirement benefits		
	1998	1999	2000	1998	1999	2000
Service cost	1,092	1,869	2,163	402	598	595
Interest cost	599	803	1,011	308	361	453
Expected return on plan assets	(421)	(548)	(675)	(228)	(225)	(267)
Amortization of transition obligation	74	74	74	—	—	—
Amortization of prior service cost	(26)	(24)	53	(14)	(14)	(14)
Amortization of loss	222	204	259	—	4	—
Net periodic benefit cost	1,540	2,378	2,885	468	724	767

The net periodic benefit cost is included in selling, general and administrative expenses in the accompanying statements of operations.

For measurement purposes, an annual rate of increase in the per capita cost of covered health and dental care benefits of 4% was assumed for 2000, 1999 and 1998. The rate was assumed to increase gradually to 8% for 2002 then decrease gradually to 5% for 2007 and remain at that level thereafter.

Assumed health care cost trend rates have an effect on the amounts reported for the post-retirement medical benefit plan. A one-percentage point change in assumed health care cost trend rates would have the following effects:

	One-percentage point	
	Increase	Decrease
Effect on total of service and interest cost components:		
Service cost	73	58
Interest cost	38	31
Effect on the post-retirement benefit obligation	674	555

The subsidiaries Indústria Aeronáutica Neiva S.A.—NEIVA, ELEB—Embraer Liebherr Equipamentos do Brasil S.A. and Embraer Aviation International—EAI have private supplementary retirement plans for their employees; the plans are the defined contribution type, and participation by the employees is optional. During 2000, these subsidiaries contributed R$128, R$52 and R$287 to the plans, respectively (NEIVA R$68, ELEB R$15 and EAI R$187 in 1999).

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

23. Employee Profit Sharing

The Company has an employee profit sharing policy linked to action plans and specific goals which are established and agreed upon at the beginning of each year. On December 31, 2000, the Company recognized an expense for employee profit sharing in the amount of R$81,684 (R$42,188 in 1999 and R$22,198 in 1998).

24. Interest Income (Expense)

	For the year ended December 31,		
	1998	1999	2000
Interest expense:			
Interest and commissions on loans	(71,043)	(91,026)	(84,601)
Interest and premium on debentures	—	(5,177)	(3,966)
Interest on taxes in litigation	—	—	(22,354)
Expenses of Global equity offering	—	—	(19,157)
CPMF (tax on bank account transactions)	(6,187)	(13,707)	(21,920)
Interest on refinanced taxes	(4,322)	(3,028)	(2,426)
Premium on preferred class "B" shares	(3,487)	(1,365)	—
Credit insurance	(3,606)	(4,976)	(3,725)
Royalties to BNDES on aircraft sold	(5,080)	(9,391)	(11,698)
Structuring finance cost	(2,030)	(10,459)	(2,617)
Tax on interest on foreign loan	(1,691)	(3,635)	(5,590)
Other	(251)	(7,254)	(8,203)
	(97,697)	(150,018)	(186,257)
Interest income:			
Temporary cash investments	43,990	16,354	71,741
Gain on public debt certificates	8,589	—	—
Interest on PROEX and customers accounts receivable and guarantee deposits	4,778	6,427	14,948
Discount on payment in advance	548	2,572	3,363
Other	3,333	6,097	14,117
	61,238	31,450	104,169

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

25. Monetary and Exchange Variations, Net

	For the year ended December 31,		
	1998	1999	2000
Exchange variations:			
Assets—			
Accounts receivable	31,830	126,459	64,263
Advances to suppliers	3,826	7,116	1,452
Other	2,420	5,316	3,609
	38,076	138,891	69,324
Allocated loss on monetary items	—	(76,297)	(81,666)
Exchange variations on assets, net	38,076	62,594	(12,342)
Liabilities—			
Advances from customers	(19,965)	(154,855)	(68,405)
Loans	(45,851)	(448,169)	(60,891)
Suppliers	(14,837)	(125,323)	(31,828)
Accounts payable	(7,047)	(48,218)	(28,504)
Other	(1,239)	(10,595)	(7,435)
	(88,939)	(787,160)	(197,063)
Allocated gain on monetary items	—	356,907	247,064
Exchange variations on liabilities, net	(88,939)	(430,253)	50,001
Exchange variations, net	(50,863)	(367,659)	37,659
Monetary variations:			
Assets—			
Accounts receivable	869	2,710	85
Other	1,480	2,042	409
	2,349	4,752	494
Allocated loss on monetary items	—	(13,502)	(5,406)
Monetary variations on assets, net	2,349	(8,750)	(4,912)
Liabilities—			
Contingencies	(6,585)	(4,595)	(753)
Loans	(8,418)	(10,834)	(6,140)
Advances from customers	(3,755)	(20,448)	(525)
Refinanced taxes	(1,414)	(7,002)	—
Accounts payable	(1,341)	(2,061)	(4,368)
Debentures	—	(22,018)	(19,251)
Taxes on gross financial income	—	(19,416)	(9,522)
Other	(806)	(2,770)	(733)
	(22,319)	(89,144)	(41,292)
Allocated gain on monetary items	—	125,502	5,644
Monetary variations on liabilities, net	(22,319)	36,358	(35,648)
Monetary variations, net	(19,970)	27,608	(40,560)
Monetary and exchange variations, net	(70,833)	(340,051)	(2,901)

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

26. Other Operating Expense, Net

	For the year ended December 31,		
	1998	1999	2000
Provision for contingencies(a)	(722)	(9,193)	(12,176)
Unallocated costs(b)	(4,545)	—	—
Losses on inventories	(27,149)	—	—
Product modifications	(5,406)	(2,192)	(7,470)
Improvements on production process	(1,128)	(2,215)	(9,655)
Royalties received (paid)	(505)	4,323	768
Insurance recovery	1,031	284	1,152
Liquidated damages receivable (payable), net	(2,440)	4,710	7,712
Reimbursement of expenses	—	6,477	1,076
Provision for realization of recoverable value-added tax	(5,790)	—	—
Gain on prepayment of financed tax	6,258	—	—
Feasibility study costs on ERJ 170 development	—	(20,883)	(31,525)
Provision for losses on contracts(c)	—	—	(6,829)
Provision for losses on other accounts receivable	—	(1,795)	(8,950)
Valuation allowance on leased aircraft	(1,306)	(3,629)	—
Other	1,296	5,092	(3,889)
	(40,406)	(19,021)	(69,786)
Unallocated inflationary effects	—	18,808	14,390
	(40,406)	(213)	(55,396)

(a) The contingencies provisions recorded in 1999 are mainly related to contribution of FUNDAF (Special Fund for Development and Improvement of Fiscalization) as described in Note 17. The contingency expenses recorded in 2000 are related to the increase of the provision for labor contingencies accrued in 1999, due to recomputation of amounts in dispute based on work performed by an independent expert.

(b) Unallocated costs are related to the depreciation of administrative buildings, and not related to production activities.

(c) This refers to cost overruns expected to be incurred in the manufacturing of a new aircraft prototype—AL-X, for the Brazilian Air Force.

27. Nonoperating Income (Expense), Net

	For the year ended December 31,		
	1998	1999	2000
Sale and rental of property items	201	1,660	1,894
Write-off of deferred charges	—	(58,533)	—
Permanent write-down of financial assets	(3,474)	(104)	—
Provision for losses on investments—fiscal incentive	—	—	(14,480)
Gain on equity investment	—	—	35,988
Other	(1,862)	(1,998)	(929)
	(5,135)	(58,975)	22,473

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

The gain on equity investment is derived from the capital increase by third parties in the subsidiary ELEB—Embraer Liebherr Equipamentos do Brasil S.A., which was made at market value, exceeding the book value of the shares subscribed for.

28. Responsibilities and Commitments

As of December 31, 2000, the Company was jointly liable with one of its customers with regard to export financing, in the amount of R$500. The banks providing such export financing have the right to demand payment from the Company if the customer does not make payment.

The Company may have to repurchase a number of aircraft. The price per aircraft on any such required repurchase is less than the original sales price of the aircraft and less than management's current estimate of the market value of the relevant aircraft type in the future years (based on current third-party appraisals of the same type of aircraft). If the Company is required to repurchase all of the relevant aircraft under the Company's repurchase obligation, which covers the period from 2003 to 2007, the Company may be required to pay up to approximately US$500 million for these aircraft. Based on the Company's current estimates and third-party appraisals, management believes that any repurchased aircraft could be sold in the market without a loss.

The Company is also subject to trade-in options for approximately 5% of the firm orders, including aircraft which have already been delivered. These options provide that the repurchase price, can be applied to the price of an upgraded model or any of the Company's other aircraft. The repurchase price is determined in the manner discussed above for regional jets and as a percentage of original purchase price for corporate jets. The Company may be required to accept trade-in options at repurchase prices that are above the then market price of aircraft. The Company is not able to determine the extent of its financial exposure under these trade-in options, which may result in substantial losses in the event that the repurchase prices are above the then market price of aircraft.

The Company has also guaranteed directly or indirectly the minimum residual value of some of its aircraft, including aircraft that have already been delivered. These guarantees run in favor of certain customers or providers of financing to customers. In accordance with the Company policy and based on third-party appraisals, this minimum residual value does not exceed the appraisal value of each aircraft delivered. The value of the guarantee typically ranges from 18% to 25% of the sales price in the 15th year after the year of delivery. The Company is not able to determine the terms nor the extent of its financial exposure under these guarantees, which may result in substantial payments in the event that actual residual values of the related aircraft decline below the guaranteed levels.

The subsidiary Embraer Aircraft Corporation—EAC is obligated under noncancellable operating leases for land and equipment. Such leases expire at various dates through 2020.

Future minimum lease payments are as follows:

Year	R$
2001	1,229
2002	1,195
2003	935
2004	636
2005	636
Thereafter	6,571
	11,202

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

The installations of Embraer Aircraft Corporation—EAC are located on land leased under a lease extending through the year 2020; the lease includes a clause which obligates EAC to make investments, totaling R$19,777. Management believes that this obligation has been satisfied, based upon construction projects performed by sublessees.

29. Income and Social Contribution Tax Credits

a. Tax Credits

As of December 31, 2000, the Company and its subsidiaries had tax loss carryforwards for income and social contribution taxes, for which there are no expiration dates for utilization, composed as follows:

	At December 31, 2000	
Year	Income tax	Social contribution
1991	889	—
1992	115,848	2,390
1993	21,720	14,286
1994	74,874	2,339
1995	209,525	3,499
1996	219,833	141,953
1997	71,168	28,265
1998	13	13
1999	82	82
2000	19	19
	713,971	192,846

Through December 31, 1998, deferred tax assets on tax loss carryforwards were recognized only when it was assured beyond a reasonable doubt that the assets would be recovered by taxes payable in the following three years based on internal studies and projections. As from January 1, 1999, the Company adopted the criteria of recognizing deferred tax assets on tax loss carryforwards when realization, based on internal studies and projections, is probable. As a result, an additional deferred tax asset in the amount of R$96,076 was recognized in 1999.

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

The components of deferred tax assets and liabilities, at December 31, 1998, 1999 and 2000, are as follows:

	At December 31,		
	1998	1999	2000
Deferred income tax assets on:			
Income tax losses	376,509	289,423	178,493
Social contribution tax losses	60,722	52,391	17,356
Valuation allowance	(267,026)	—	—
Tax loss carryforwards, net	170,205	341,814	195,849
Temporary differences—			
Reserve for contingencies	20,169	10,355	5,599
Provision for realization of investments	2,187	1,437	1,674
Provision for losses on deferred charges	20,998	611	555
Provision for product warranties	6,034	15,786	26,482
Provision for product improvement	—	—	28,894
Accrued taxes other than income taxes	1,048	20,444	48,088
Reserve for inventories	9,403	12,906	50,044
Provision for realization of prepaid value-added tax	1,912	1,640	8,396
Pension accrual	662	1,410	1,771
Provision for losses on contracts	6,139	3,097	4,465
Allowance for doubtful account	—	1,462	1,432
Trade Concession	—	—	9,218
Other	9,313	14,851	19,635
	77,865	83,999	206,253
Total assets	248,070	425,813	402,102
Deferred income tax liabilities on:			
Temporary differences—			
Fixed asset revaluation	(29,040)	(23,565)	(20,794)
Special monetary restatement—IPC index	(11,521)	(19,991)	(10,091)
Equity pick-up from subsidiary located in tax haven	(4,263)	(4,041)	(13,265)
Exchange variation	—	(7,016)	(1,360)
Difference in revenue recognition	(669)	(4,387)	(1,926)
Accelerated depreciation	—	(378)	(1,623)
Other	(1,856)	(1,990)	(2,641)
Effect of monetary restatement adjustments	(56,835)	(112,946)	(99,509)
Total liabilities	(104,184)	(174,314)	(151,209)
Net deferred tax assets	143,886	251,499	250,893

The aforementioned studies indicate that the present amounts should be realized within three years.

The deferred tax on full indexation (''Effect of monetary restatement'') relates to the difference between the tax basis of nonmonetary assets, which was not indexed for inflation subsequent to December 31, 1995, and the reporting basis, which includes indexation through December 31, 2000.

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

The net deferred tax assets were reflected in the consolidated balance sheets as follows:

	At December 31,		
	1998	1999	2000
Deferred income tax assets:			
Current	5,838	114,175	230,725
Noncurrent	242,232	311,638	171,377
	248,070	425,813	402,102
Deferred income tax liabilities:			
Current	—	(7,016)	(1,360)
Noncurrent	(104,184)	(167,298)	(149,849)
	(104,184)	(174,314)	(151,209)
	143,886	251,499	250,893

b. Reconciliation Between Tax Expense and Statutory Tax Rate

Brazilian income taxes comprise federal income tax and social contribution tax. In 1998, 1999 and 2000, the rate was 25% for income tax, and for social contribution rates were 8% from January 1998 to April 1999, 12% from May 1999 to January 2000 and 9% from February to December 2000. The changes produced a combined statutory tax rate of approximately 33% in 1998, 37% in 1999 and 34% in 2000.

Deferred taxes are provided on temporary differences which include the effects of indexation adjustments that will not give rise to deductions when subsequently depreciated, amortized or disposed of.

The following is an analysis of the income tax (expense) benefit:

	For the year ended December 31,		
	1998	1999	2000
Deferred income tax assets:			
On loss carryforwards—			
Loss carryforwards for the year	340	—	—
Reduction in the valuation allowance	27,985	267,026	—
Loss on carryforwards losses exposed to inflation	—	(73,175)	(30,932)
Offset taxable income for the year	—	(22,242)	(115,033)
	28,325	171,609	(145,965)
Temporary differences—			
Additions	—	—	131,922
Reversals	(59,262)	(7,885)	—
Effect of monetary restatement adjustment	21,255	(56,111)	44,662
	(38,007)	(63,996)	176,584
Current income tax	(6,007)	(82,177)	(287,213)
Income tax (provision) credit	(15,689)	25,436	(256,594)

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

The following is a reconciliation of the reported income tax expense (benefit) and the amount calculated by applying the combined statutory tax rate of 33% in 1998, 37% in 1999 and 34% in 2000.

	For the year ended December 31,		
	1998	1999	2000
Income before taxes as reported in the accompanying consolidated financial statements	124,467	483,844	780,683
Tax at the combined statutory rate	41,073	179,023	265,432
Permanent additions:			
Equity pickup	3,757	5,139	—
Nondeductible expenses	3,156	1,871	4,090
Donations	—	—	2,257
Other	76	407	—
	6,989	7,417	6,347
Permanent exclusions:			
Equity pickup	(1,219)	—	—
Interest on capital	—	—	(36,100)
Exchange rate fluctuation on foreign investments recorded under equity method	(1,995)	(13,414)	(3,124)
Employee benefits	(157)	—	—
Reversal of special monetary restatement—IPC index	(5,518)	(539)	(2,555)
Gain on equity investment	—	—	(12,236)
Others	(17)	(4,256)	(64)
	(8,906)	(18,209)	(54,079)
Other items:			
Loss on deferred income tax exposed to inflation	—	73,175	33,931
Countries tax rate difference	(309)	1,213	—
Unrealized profit on inventories	4,827	3,332	3,627
Statutory tax rate (increase) decrease	—	(4,361)	1,336
Subtotal	43,674	241,590	256,594
Reduction of valuation allowance of deferred tax asset	27,985	267,026	—
Income tax expense (benefit) as reported in the accompanying financial statements	15,689	(25,436)	256,594

During 1998, the Company revised its projected taxable income for the following three years, based on the increase in sales and backlog generated during those years. Based on these projections, the amount of tax loss carryforwards for which realization became probable increased significantly, and the related deferred tax assets were recognized.

30. Summary of Differences Between Brazilian GAAP and U.S. GAAP as Related to the Company

30.1. Description of the GAAP Differences

The Company's accounting policies comply with, and its consolidated financial statements are prepared in accordance with, Brazilian GAAP. A summary of the Company's principal accounting policies that differ significantly from generally accepted accounting principles in the United States (''U.S. GAAP'') is set forth below.

a. Price-level Adjustments and U.S. GAAP Presentation

The effects of price-level adjustments have not been eliminated in the reconciliation to U.S. GAAP nor are the monetary gains or losses associated with the various U.S. GAAP adjustments separately identified, because the application of inflation restatement represents a comprehensive measure of the effects of price-level changes in the Brazilian economy and, as such, is considered a more meaningful presentation than historical cost-based financial reporting for both Brazilian and U.S. accounting purposes.

b. Foreign Currency Translation

Under Brazilian GAAP, the financial statements of subsidiaries are translated using the current exchange rate. Translation gains and losses arising from the effects of devaluation (or appreciation) of the local currency in relation to the foreign currency, when translating the financial statements of foreign subsidiaries for the computation of equity pickup and consolidation, are allocated to financial expenses. Financial statements presented in weak currencies are adjusted for the effects of inflation prior to translation. Brazilian GAAP does not recognize a functional currency for a Brazilian company reporting in reais.

Under U.S. GAAP, Statement of Financial Accounting Standards (''SFAS'') No. 52 requires that the translation of foreign currency financial statements be made using the current exchange rate, except for enterprises operating in highly inflationary environments (a cumulative inflation rate of approximately 100% or more over a three-year period); in this case the functional currency is considered to be the reporting currency. Translation gains and losses are reported as a separate component of shareholders' equity, usually named ''cumulative translation gains and losses'', except those relating to financial statements of enterprises operating in highly inflationary environments, which are included in the income statement.

The majority of the Company's sales revenues, cost of sales, and financing costs are denominated in or are indexed to the U.S. dollar. Therefore, management has used the U.S. dollar as its functional currency. The effects of translating the balance sheet from U.S. dollars to the reporting currency (the Brazilian real) are included in equity as cumulative translation adjustment.

c. Revaluation of Property, Plant and Equipment

Revaluations (appraisals) may be recorded under Brazilian GAAP, providing that certain formalities are complied with. The revaluation increment, net of deferred tax effects, is credited to a reserve account in shareholders' equity and systematically transferred to retained earnings as the related assets are depreciated or upon disposal. As from July 1, 1995, companies may opt to carry property, plant and equipment at cost, monetarily adjusted up to December 31, 1995, or at appraised values, in which case the revaluations must be performed at least every four years and should not result in an amount higher than the value expected to be recovered through future operations. Deferred taxes must be recognized on revaluation increments as from July 1, 1995.

Under U.S. GAAP, property, plant and equipment are reported at their historical cost less accumulated depreciation; revaluations, as mentioned above, are not permitted.

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

The effects of these different criteria for revaluation and its depreciation are presented as follows:

	At December 31,		
	1998	1999	2000
Reversal of fixed assets revaluation:			
Cost	(422,305)	(422,305)	(427,452)
Accumulated depreciation	174,428	185,858	198,762
U.S. GAAP difference in shareholders' equity	(247,877)	(236,447)	(228,690)

d. Deferred Charges

Under Brazilian GAAP, research and development costs for new aircraft types as well as new production lines or operations are capitalized or deferred for amortization over the period of time from the date the related production benefits or operations begin.

Under U.S. GAAP, the research and development costs incurred by the Company would be divided into two categories, research and development cost and additions to fixed assets. The research and development cost is the expense actually associated with the design and development of the aircraft. Under U.S. GAAP, these costs are expensed in the year in which they are incurred. Additions to fixed assets would relate solely to specialized equipment (tooling) built by the Company and required for the project. These cash outflows are treated as additions to property, plant and equipment. The amounts allocated to property, plant and equipment (tooling) are being depreciated on a straight-line basis over twenty years under U.S. GAAP.

The effects of these different criteria for deferred charges, net of amortization, are presented as follows:

	At December 31,		
	1998	1999	2000
Reversal of deferred charges:			
Cost	(1,001,084)	(982,067)	(1,125,408)
Accumulated amortization	438,223	562,711	757,233
	(562,861)	(419,356)	(368,175)
Capitalized tooling:			
Cost	223,939	152,915	174,226
Accumulated depreciation	(103,674)	(68,249)	(86,660)
	120,265	84,666	87,566

e. Computer Software Obtained for Internal Use

Under Brazilian GAAP, the costs incurred for computer software for internal use such as preliminary project stage internal and external costs are capitalized and amortized on a straight-line basis over a period of five to ten years.

Under U.S. GAAP, the costs incurred for computer software for internal use such as preliminary project stage internal and external costs should meet specific characteristics in order to be capitalized or expensed.

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

The effects of these different criteria for capitalizing computer software cost are presented below:

	1998	1999	2000
Reversal of computer software obtained for internal use recorded in deferred charges under Brazilian GAAP	(6,428)	—	—

f. Capitalization of Finance Costs During Construction or Production

Under Brazilian GAAP, as from 1996, for listed companies, the CVM permits capitalization of interest costs incurred as part of the production costs of property, plant and equipment. Exchange gains and losses may be capitalized only if they exceed monetary correction. The Company, however, has not capitalized any interest during the periods for which the financial statements are being presented.

Under U.S. GAAP, in accordance with the provisions of SFAS No. 34, ''Capitalization of Interest Costs'', interest incurred on borrowings is capitalized to the extent that borrowings do not exceed construction-in-progress. The credit is a reduction of interest expense. Under U.S. GAAP, the amount of interest capitalized excludes the foreign exchange gains and losses on foreign currency borrowings.

The effects of these different criteria for capitalizing and amortizing capitalized interest are presented below:

	At December 31,		
	1998	1999	2000
Capitalized interest:			
Tooling recorded in deferred charges	11,284	11,756	11,883
Construction-in-progress	74,115	75,202	77,159
Write-off related to EMB 120	—	(9,603)	(9,603)
	85,399	77,355	79,439
Depreciation of capitalized interest difference:			
Tooling	(5,111)	(5,890)	(6,107)
Construction-in-progress	(43,957)	(45,075)	(48,348)
Write-off related to EMB 120	—	5,159	5,159
	(49,068)	(45,806)	(49,296)
Capitalized interest net of depreciation, under U.S. GAAP	36,331	31,549	30,143

g. Leasing Transactions

Under Brazilian GAAP, generally, lessees account for long-term leases as operating leases, whereas in accordance with U.S. GAAP such leases could be accounted for as operating or capital leases. As a result, under Brazilian GAAP, lease payments by lessees with respect to leases are charged as an expense as incurred. Under U.S. GAAP, the lease payments may be charged as an expense as incurred (operating leases) or the leased asset and the corresponding lease liability may be recognized in the balance sheet and the effect of depreciation and interest expense in the results of operations (capital leases).

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

The effects of these different criteria for lease payments and depreciation of capitalized leases are presented below:

	At December 31,		
	1998	1999	2000
Reversal of lease payment recorded in expenses under Brazilian GAAP	1,475	6,826	19,109
Depreciation of equipment lease recorded in fixed assets and interest on lease financing under U.S. GAAP	(1,062)	(5,256)	(12,415)
U.S. GAAP differences in shareholders' equity	413	1,570	6,694

h. Income Taxes

Except for long-lived asset write-ups, which would not be recognized under U.S. GAAP, the Company accrues for all temporary differences. Under Brazilian GAAP until to December 31, 1998, tax assets on tax loss carryforwards were recognized only when it is assured beyond reasonable doubt that the assets would be recovered against taxes payable in the next three years based on internal studies and projections. Additionally, the Company reports deferred tax assets net of deferred tax liabilities. As from January 1, 1999, the Company adopted the criteria of recognizing deferred tax assets on tax loss carryforwards when realization, based on internal studies and projections, is more likely than not.

Under U.S. GAAP, deferred taxes are recognized under the liability method for temporary differences between the financial accounting and income tax basis of assets and liabilities, and significant tax disclosures are required. Deferred tax benefits are recognized when it is more likely than not that a tax benefit will be realized. As from January 1, 1999 the Company is adopting the same criteria in its Brazilian GAAP financial statements.

Under Brazilian GAAP, at December 31, 1999, the Company recognized a change in the tax rate from 33% to 34% caused by a new rate as from January 1, 2000 based on a provisional measure. Provisional measures are temporary and must be reapproved every 30 days or they lapse. Under U.S. GAAP, at December 31, 1999 the deferred income tax is recognized at the effective rate of 33%, based on the provisions of the enacted tax law, not based on the provisional measure.

Additionally, under U.S. GAAP, the portion of deferred tax effect on the indexation for financial report purpose in the amount of R$31,225 charged to shareholders' equity in 2000 would be charged to income.

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

The results of such differences are described below:

	At December 31,		
	1998	1999	2000
Deferred income tax asset on:			
Tax loss carryforwards	376,509	289,423	178,493
Social contribution	60,721	52,391	17,356
Valuation allowance	(222,424)	—	—
	214,806	341,814	195,849
Assets—temporary differences	76,850	84,000	206,254
Deferred tax asset under Brazilian GAAP	291,656	425,814	402,103
Deferred tax asset on U.S. GAAP reconciling items	338,244	208,751	185,319
Deferred income tax asset under U.S. GAAP, net of valuation reserve	629,900	634,565	587,422
Deferred income tax liabilities on:			
Liabilities—temporary differences	(46,332)	(61,369)	(51,700)
Monetary restatement on fixed assets	(56,835)	(112,945)	(99,509)
Deferred tax liability on U.S. GAAP reconciling items	(12,125)	(13,801)	(15,584)
Deferred income tax liabilities under U.S. GAAP	(115,292)	(188,115)	(166,793)

i. Reversal of Proposed Dividends

Under Brazilian GAAP, proposed dividends are accrued for in the financial statements in anticipation of their approval at the Shareholders' Meeting. Under U.S. GAAP, dividends are not accrued until they are formally declared.

The effects of these different criteria for accrued for dividends are presented below:

	At December 31,		
	1998	1999	2000
Proposed dividends	45,450	96,714	108,996

j. Statement of Cash Flows

Under Brazilian GAAP, a statement of changes in financial position is required to be presented which depicts the source and application of funds in terms of change in working capital.

Under U.S. GAAP, presentation of a statement of cash flows describing the cash flows provided by or used in operating, investing and financing activities is required.

k. Segment Information

Under Brazilian GAAP, there is no requirement for financial reporting for segments.

Under U.S. GAAP, SFAS No. 131, ''Financial Reporting for Segments of a Business Enterprise'', sets forth standards for reporting of revenues, operating profits or losses and identifiable assets, as defined for industry segments and foreign and domestic operations which meet specific materiality criteria. Export sales by geographic areas and sales to significant customers, including government customers, must also be disclosed.

l. Financial Instruments and Concentration of Credit Risk

Under Brazilian GAAP, financial instruments and derivatives may be accounted for at cost, contract value or market value with footnote disclosure of the type and amounts of financial instruments and derivatives.

U.S. GAAP accounting and disclosure is governed by SFAS No. 80, ''Accounting for Futures Contracts'', SFAS No. 105, ''Disclosure of Information About Financial Instruments with off-balance Sheet Risk and Concentration of Credit Risk'', SFAS No. 107, ''Disclosures About Fair Value of Financial Instruments'', and SFAS No. 119, ''Disclosure About Derivative Financial Instruments and Fair Value of Financial Instruments''. Financial instruments and derivatives may be accounted for at cost, contract value or market value with footnote disclosure of the type and amounts of financial instruments and derivatives.

m. Earnings per Share

Under Brazilian GAAP, disclosure of earnings per share is computed based on the number of shares outstanding at the end of the year.

In February 1997, the Financial Accounting Standards Board issued SFAS No. 128, ''Earnings per Share''. This new statement became effective on December 15, 1997 and provides computation, presentation and disclosure requirements for earnings per share.

Because the preferred and common shareholders have different dividend, voting and liquidation rights, basic and diluted earnings per share have been calculated using the ''two-class'' method. The ''two-class'' method is an earnings allocation formula that determines earnings per share for preferred and common stock according to the dividends to be paid as required by the Company's bylaws and participation rights in undistributed earnings.

Basic earnings per common share are computed by deducting net income by distributed and undistributed net income available to preferred shareholders and dividing net income available to common shareholders by the weighted average number of common shares outstanding during the period. Net income available to preferred shareholders is the sum of the preferred stock dividends and the preferred shareholders' portion of undistributed net income. Undistributed net income is computed by deducting total dividends (the sum of preferred and common stock dividends) from net income. Undistributed net income attributed to preferred shareholders results in earnings per share 10% greater than those attributed to common shareholders. Total dividends are calculated as described in Note 18. Diluted earnings per share are computed similarly to the basic earnings per share, except that the outstanding shares are increased to include the number of additional shares that would have been outstanding if the dilutive potential shares had been issued. In addition, in computing the effect of convertible debt, the net income available is adjusted to add back interest recognized in the period associated with convertible debt after tax.

The weighted average number of common and preferred shares used in computing basic earnings per share for December 31, 2000 was 242,544,448 and 270,027,741, respectively. The computation of basic and diluted earnings per share is as follows:

	At December 31, 1998			At December 31, 1999			At December 31, 2000		
	Common	Preferred	Total	Common	Preferred	Total	Common	Preferred	Total
	In thousands, except per share data and percentages								
Basic numerator:									
Actual dividends declared	35,536	38,463	73,999	68,376	74,015	142,391	134,305	168,276	302,581
Basic allocated undistributed earnings (a)	64,443	69,757	134,200	167,874	181,717	349,591	108,256	128,774	237,030
Allocated net income available for common and preferred shareholders	99,979	108,220	208,199	236,250	255,732	491,982	242,561	297,050	539,611
Basic denominator:									
Weighted average shares	242,544	238,673		242,544	238,673		242,544	270,028	
Basic earnings per share	0.41	0.45		0.97	1.07		1.00	1.10	
Diluted numerator:									
Actual dividends declared	35,221	38,777	73,998	58,266	84,126	142,392	114,097	188,484	302,581
Diluted allocated undistributed earnings (a)	64,518	71,031	135,549	143,402	207,049	350,451	91,613	148,074	239,687
	99,739	109,808	209,547	201,668	291,175	492,843	205,710	336,558	542,268
Allocated net income available for common and preferred shareholders	99,098	109,101	208,199	201,315	290,667	491,982	204,708	334,903	539,611
Interest expense on convertible debt, net of tax (b)	641	707	1,348	353	508	861	1,002	1,655	2,657
Allocated dilutive net income available for common and preferred Shareholders	99,739	109,808	209,547	201,668	291,175	492,843	205,710	336,558	542,268
Diluted denominator:									
Weighted average shares	246,175	244,299		246,175	251,549		242,544	358,657	
Convertible debt (b)	—	—		—	70,108		—	—	
Redemption of convertible debt —class ‘‘B’’ shares	—	—		(2,338)	(3,622)		—	—	
Stock options (b)	—	3,248		—	2,022		—	2,089	
Diluted weighted average shares	246,175	247,547		243,837	320,057		242,544	360,746	
Diluted earnings per share	0.41	0.44		0.83	0.91		0.85	0.93	

(a) The Company calculates earnings per share on common and preferred shares under the ‘‘two-class method’’. Effective January 1, 1997, preferred shareholders are entitled to receive per-share dividends of at least 10% greater than the per-share dividends paid to common shareholders. Undistributed earnings, therefore, from January 1, 1997 forward have been allocated to common and preferred shareholders on a 100 to 110 basis, respectively, based upon the weighted average number of shares outstanding during the period to total shares (allocation percentage). Because the allocation percentage for each class differs for basic and diluted Earnings per Share ‘‘EPS’’ purposes, allocated undistributed earnings differ for such calculations.

(b) For purposes of computing diluted Earnings per Share ‘‘EPS’’, subscription warrants and stock options are assumed to be converted into common and preferred shares as of the date of issuance of the security using the treasury stock method.

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

Weighted Average Shares Outstanding—Basic

	Common shares			Preferred shares		
	Shares	Fraction of period	Weighted Average shares	Shares	Fraction of period	Weighted Average shares
January 1 through December 31, 1998	242,544,448	365	242,544,448	238,673,426	365	238,673,426
January 1 through December 31, 1999	242,544,448	365	242,544,448	238,673,426	365	238,673,426
January 1 through February 17, 2000	—	—	—	238,673,426	48	31,301,433
Subscription—February 18, 2000	—	—	—	8,335,000	—	—
February 19 through July 20, 2000	—	—	—	247,008,426	154	103,932,507
Subscription—July 21, 2000	—	—	—	52,800,000	—	—
July 22 through July 27, 2000	—	—	—	299,808,426	7	5,734,041
Subscription—July 28, 2000	—	—	—	1,057,000	—	—
July 29, 2000 to December 31, 2000	—	—	—	300,865,426	157	129,059,760
Weighted average	242,544,448	366	242,544,448	300,865,426	366	270,027,741

Weighted Average Shares Outstanding—Diluted

	Common shares			Preferred shares		
	Shares	Fraction of period	Weighted Average shares	Shares	Fraction of period	Weighted Average shares
January 1 through May 30, 1998(1)	246,175,246	151	101,842,362	244,299,007	151	101,066,165
Increase in capital—May 31, 1998(2)	—	—	—	5,250,000	—	—
May 31 through November 29, 1998	—	—	—	249,549,007	183	125,116,351
Increase in capital—November 30, 1998(2)	—	—	—	2,000,000	—	—
November 30 through December 31, 1998	246,175,246	214	144,332,884	251,549,007	31	21,364,436
Weighted average	—	365	246,175,246	—	365	247,546,952

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

Weighted Average Shares Outstanding—Diluted

	Common shares			Preferred shares		
	Shares	Fraction of period	Weighted Average shares	Shares	Fraction of period	Weighted Average shares
January 1 through May 10, 1999	246,175,246	130	87,678,855	251,549,007	56	38,593,820
Increase in capital—February 25, 1999(3)	—	—	—	71,059,000	—	—
February 26 through March 3, 1999	—	—	—	322,608,007	6	5,303,145
Increase in capital—March 4, 1999(3)	—	—	—	2,000	—	—
March 4 through March 10, 1999	—	—	—	322,610,007	7	6,187,041
Increase in capital—March 11, 1999(3)	—	—	—	12,269,000	—	—
March 11 through May 10, 1999	—		—	334,879,007	61	55,966,081
Redemption of capital—May 11, 1999(4)	(3,630,798)	—	—	(5,625,580)	—	—
May 11 through December 31, 1999	242,544,448	235	156,158,754	—	—	—
May 11 through May 30, 1999	—	—	—	329,253,427	20	18,041,284
Increase in capital—May 31, 1999(2)	—	—	—	3,100,000		—
May 31 through November 30, 1999	—	—	—	332,353,427	184	167,542,550
Increase in capital—November 30, 1999(2)	—	—	—	2,300,000		
November 30 through December 31, 1999	—	—	—	334,653,427	31	28,422,620
Weighted average	—	365	243,837,609	—	365	320,056,541

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

Weighted Average Shares Outstanding—Diluted

	Common shares			Preferred shares		
	Shares	Fraction of period	Weighted Average shares	Shares	Fraction of period	Weighted Average shares
January 1 through February 17, 2000	242,544,448	151	100,066,152	334,653,427	151	138,067,397
Increase in capital May 31, 2000(2)	—	—	—	3,950,000	—	—
May 31 through July 20, 2000	242,544,448	51	33,797,177	338,603,427	51	47,182,445
Increase in capital July 20, 2000	—	—	—	52,800,000	—	—
July 21 through November 29, 2000	242,544,448	132	87,475,047	391,403,427	132	141,161,892
Increase in capital November 30, 2000(2)	—	—	—	1,300,000	—	—
November 30 through December 31, 2000	242,544,448	32	21,206,072	392,703,427	32	34,334,726
Weighted average		366	242,544,448		366	360,746,460

(1) From January 1, 1996 through September 11, 1997, there were assumed to be outstanding the preferred and common shares which holders of the redeemable preferred class ''B'' could have received upon redeeming these shares (62,867,343 common shares and 97,407,044 preferred shares). All except for 3,275,365 of these shares of class ''B'' preferred stock were actually redeemed in September 1997.

(2) Dilutive effect of stock options issued on May 31 and November 30, 1998, 1999 and 2000, calculated using the treasury stock method.

(3) Dilutive effect of subscription warrants which holders can convert into preferred shares.

(4) Redemption of class ''B'' shares not converted into capital.

The Company's preferred shares, according to the bylaws, are non-voting except under limited circumstances and are entitled to priority over the common shares in the return of capital in proportion to their share of net worth in case of liquidation. In addition, according to the bylaws, the preferred shares are not entitled to fixed or minimum dividend payments other than their participation in the minimum dividend of 25% of adjusted net income, if available. However, under Brazilian corporation law, preferred shares not entitled to fixed or minimum dividend payments are entitled to dividends in an amount 10% greater than the dividends payable to common shares. The preferred shareholders were entitled to a noncumulative dividend of R$0.62 per preferred share in 2000. The preferred shareholders would participate in the undistributed earnings of the Company in the amount of R$0.48 per preferred share in 2000.

n. Redeemable Stock

Under Brazilian GAAP, redeemable stock is treated as paid-in capital and, accordingly, does not appear as a separate balance sheet line item. Under U.S. GAAP, redeemable stock is, in certain circumstances, treated as long-term debt.

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

The effects of these different criteria for redeemable stock are presented below:

	At December 31,		
	1998	1999	2000
Redeemable stock (class ''B'' shares)	(15,310)	—	—

o. Impairment of Long-lived Assets

Under Brazilian GAAP, the carrying values of fixed assets are written down to realizable values when it is estimated that the depreciation charges on such carrying value would cause the Company to realize net losses in future periods. Write-downs are taken in amounts necessary to eliminate such losses. Brazilian GAAP does not require cash flow computations in order to determine potential asset impairment.

For U.S. GAAP, effective January 1, 1997, the Company adopted SFAS No. 121, ''Accounting for the Impairment of Long-lived Assets and for Long-lived Assets to be Disposed of''. In accordance with this standard, the Company is required to periodically evaluate the carrying value of long-lived assets to be held and used, when events and circumstances warrant such a review. The carrying value of long-lived assets is considered impaired when the anticipated undiscounted cash flow from such assets is separately identifiable and is less than their carrying value. In that event, a loss is recognized based on the amount by which the carrying value exceeds the fair market value of the assets. The adoption of this standard did not have a material effect on the Company's financial condition or results of operations.

p. Stock Options

According to Accounting Principles Board—APB Opinion No. 25, U.S. GAAP requires measurement of compensation from employee stock options plans based on the difference between the market value at the date of grant and the grant price. As described in further details in Note 30.4.c., the Company has granted options to certain employees to purchase stock at prices below market. The total difference between the market price and option price was R$4,162 for grants in 1998, R$4,219 for grants made in 1999 and R$567 for grants made in 2000, which is recognized for U.S. GAAP purposes as an expense.

q. Tax-incentive Investments

In years with operations resulting in net taxable income, Brazilian companies may elect to apply a portion of their income tax liability to investment securities of specific projects sponsored by the government in certain industries or in less developed regions of the country. At the time such investment payment options are made, the corresponding amount is charged to a noncurrent asset account and credited to a fiscal incentive capital reserve in shareholders' equity. U.S. GAAP would require a credit to income, net of valuation reserves, if applicable. The total amounts to be credited to income are R$182 and R$25,126 in 1999 and 2000, respectively.

r. Reporting Comprehensive Income

SFAS No. 130 establishes the standards for reporting and displaying comprehensive income and its components (revenues, expenses, gains and losses) as part of a full set of financial statements. These statements require that all elements of comprehensive income be reported in a financial statement, which is displayed with the same prominence as other financial statements. The Company's cumulative translation adjustment would be reported as comprehensive income under U.S. GAAP.

Under Brazilian GAAP, the expenses associated with an offering of shares are recorded as expenses. Under U.S. GAAP, the expenses of sales of shares, net of the tax effect, are offset against the net proceeds of the offering, and therefore, are posted directly to shareholders' equity.

s. Item Posted Directly to Shareholders' Equity Accounts

Under Brazilian GAAP, grants in cash for investment from suppliers are either posted directly to shareholders' equity or accounted for as a reduction to deferred charges. Under U.S. GAAP, such grants would be recorded in the income statement as a reduction to cost of sales. All the conditions and requirements which could result in the refund of cash contributions received in relation to the ERJ 145 aircraft have already been satisfied.

Under Brazilian GAAP, the expenses associated with an offering of shares are recorded as expenses. Under U.S. GAAP, the expenses of sales of shares, net of the tax effect, are offset against the net proceeds of the offering, and therefore, are posted directly to shareholders' equity.

t. Accounting Classification

Under Brazilian GAAP, provisions for reduction of inventories to market value, obsolescence and cost related to idle capacity regarding temporary and abnormal excess capacity are included in other operating expenses. Under U.S. GAAP, such provision and expenses would have been posted to cost of sales.

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

30.2. Reconciliation of Differences Between Brazilian and U.S. GAAP

a. Net Income

	For the year ended December 31,		
	1998	1999	2000
Net income as reported	108,778	509,280	512,665
Impact of adoption of U.S. dollar as functional currency—			
Increase (Decrease) in cost of sales	(330)	(559,911)	24,074
Reversal of exchange variation	50,867	556,283	(37,658)
Increase (Decrease) in nonoperating expenses	(534)	(11,129)	—
Net income assuming U.S. dollar as the functional currency	158,781	494,523	499,081
Add (Deduct):			
Different criteria for—			
Depreciation of revaluation of fixed assets—			
Depreciation for the year	11,478	8,222	7,629
Disposals and write-offs for the year	616	3,208	128
Capitalized research and development costs—			
Additions for the year	(61,527)	(34,792)	(103,208)
Amortization for the year	100,091	126,191	154,389
Write-off for the year	—	52,106	—
Computer software obtained for internal use	(5,443)	6,428	—
Capitalized interest—			
Additions for the year	74	1,558	2,084
Depreciation for the year	(5,573)	(1,896)	(3,490)
Write-off for the year	—	(4,444)	—
Leased equipment	(24)	1,157	5,124
Compensation expense for stock options	(4,162)	(4,219)	(567)
Capitalized tooling—			
Additions for the year	4,546	21,711	21,311
Depreciation for the year	(13,032)	(16,878)	(18,411)
Write-off for the year	—	(40,432)	—
Fiscal incentive reserve	—	182	25,126
Translation adjustment on foreign investments	(6,048)	(34,255)	(9,190)
Expenses of global equity offering	—	—	12,836
Deferred income tax effect of U.S. GAAP adjustments	(8,921)	(38,916)	(21,447)
Effect of Deferred income taxes on monetary restatement of shareholder's equity	—	—	(31,225)
Statutory tax rate increase on temporary differences	—	(2,870)	(559)
Deferred income tax on loss carryforwards and temporary differences	37,343	(44,602)	—
U.S. GAAP net income	208,199	491,982	539,611
Other comprehensive income—			
Cumulative translation adjustment	23,913	86,634	18,592
Translation adjustment on foreign investments	6,048	34,255	9,190
Expenses of global equity offering	—	—	(12,836)
Comprehensive income	238,160	612,871	554,557

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

	At December 31, 1998	1999	2000
Net income per share in accordance with U.S. GAAP:			
Common shares—basic	0.41	0.97	1.00
Weighted average common shares outstanding	242,544,448	242,544,448	242,544,448
Common shares—diluted	0.41	0.83	0.85
Weighted average common shares outstanding	246,175,246	243,837,609	242,544,448
Preferred shares—basic	0.45	1.07	1.10
Weighted average preferred shares outstanding	238,673,426	238,673,426	270,027,741
Preferred shares—diluted	0.44	0.91	0.93
Weighted average preferred shares outstanding	247,546,952	320,056,541	360,746,460

b. Shareholders' equity

	At December 31, 1998	1999	2000
Total shareholders' equity as reported	707,751	1,059,510	1,761,670
Increase (Decrease) in nonmonetary items due to reflecting the U.S. dollar as functional currency:			
Inventories	59,019	(411)	19,660
Investments	515	5,251	4,975
Property, plant and equipment	(206,919)	(35,559)	(47,133)
Deferred income tax on cumulative translation adjustment	62,290	17,509	14,300
Total shareholders' equity assuming U.S. dollar as the functional currency	622,656	1,046,300	1,753,472
Add (Deduct):			
Different criteria for—			
Revaluation of fixed assets net of depreciation and disposals	(247,877)	(236,447)	(228,690)
Deferred charges reversed to income	(562,861)	(419,356)	(368,175)
Computer software obtained for internal use	(6,428)	—	—
Capitalized interest net of depreciation	36,331	31,549	30,143
Equipment leased	413	1,570	6,694
Compensation expense for stock options	(4,162)	(8,381)	(8,948)
Capitalized tooling	120,265	84,666	87,566
Reversal of proposed dividends	45,450	96,714	108,996
Reclassification of class "B" shares from shareholders' equity to long-term debt	(15,310)	—	—
Deferred income tax effect of U.S. GAAP adjustments	219,227	180,311	158,864
Statutory tax rate increase on temporary difference	—	(2,870)	(3,429)
Deferred income tax on loss carryforwards and temporary differences	44,602	—	—
U.S. GAAP shareholders' equity	252,306	774,056	1,536,493
U.S. GAAP supplementary information:			
Total assets	2,545,706	3,968,804	5,235,096
Property, plant and equipment	432,284	659,192	887,605
Accumulated depreciation	(264,842)	(269,294)	(339,204)
Net property, plant and equipment	167,442	389,898	548,401

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

30.3. Changes in shareholders' equity under U.S. GAAP

	For the year ended December 31,		
	1998	1999	2000
Beginning balance	42,694	252,306	774,056
Capital increase	—	—	498,179
Net income	208,199	491,982	539,611
Dividends	(28,548)	(91,122)	(290,299)
Cumulative translation adjustment net of deferred income tax	23,913	86,635	18,592
Translation adjustment on foreign investments	6,048	34,255	9,190
Expenses of global equity offering	—	—	(12,836)
Ending balance	252,306	774,056	1,536,493

30.4. Additional disclosure required by U.S. GAAP

a. Statement of cash flow

a.1. In Brazilian GAAP

	For the year ended December 31,		
	1998	1999	2000
Operating activities:			
Net income for the year	108,778	509,280	512,665
Adjustments to reconcile net income to net cash provided by operating activities—			
Depreciation and amortization	151,900	185,615	217,427
Allowance for doubtful accounts	10,543	19,199	6,506
Gain on permanent asset disposals	9,218	1,125	1,983
Write-off of deferred charges	—	58,533	—
Provision for losses	725	9,352	13,883
Reversal of deferred income	(1,069)	(912)	(12)
Deferred income taxes and social contribution tax	11,889	(107,612)	(30,630)
Reduction of penalties—INSS refinanced	(6,258)	—	—
Interest on loans, tax installments and debentures	64,732	113,592	86,497
Reserve for (Reversal of) contingencies	(2,820)	7,019	16,597
Monetary and exchange variation on loans, tax installments and debentures	57,908	232,912	(13,715)
Translation adjustment on consolidated foreign investment	(6,048)	(34,255)	(9,190)
Provisions for losses on contracts	(4,040)	(18,682)	—
Reversal of reserve for realization of value-added tax credits	(5,789)	—	—
Equity in unconsolidated subsidiary	(218)	283	(1,493)
Write off of investments	—	—	68
Minority interest	—	—	11,424
	389,451	975,449	812,010

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

	For the year ended December 31,		
	1998	1999	2000
Changes in current assets and liabilities—			
Accounts receivable	(103,636)	(70,723)	(72,931)
Inventories	(373,426)	(587,191)	341,186
Prepaid expenses	126	746	(7,199)
Deferred and recoverable taxes	(11,210)	(8,654)	24,641
Other receivables	(15,949)	(12,123)	3,786
Suppliers	78,907	66,015	129,112
Accrued taxes on income	3,307	25,625	49,973
Accrued liabilities	41,086	73,199	228,718
Customers advances	(425)	203,901	141,979
Taxes and social charges payable	9,905	50,676	73,866
Other	16,756	7,448	69,442
	(354,559)	(251,081)	982,573
Changes in noncurrent assets and liabilities—			
Accounts receivable	(23,915)	(337,692)	331,993
Recoverable taxes	2,264	(7,498)	(754)
Other receivables	(6,909)	11,584	20,605
Suppliers	(4,477)	(6,038)	—
Accounts payable	(648)	27,163	1,155
Customers advances	55,290	67,044	(63,639)
Deferred income	(299)	—	(41)
Accrued liabilities	(30,882)	(46,865)	(30,801)
Taxes payable	711	—	(3,347)
Minority interest	—	—	8,977
	(8,865)	(292,302)	264,148
Net cash provided by operating activities	26,027	432,066	2,058,731
Investing activities:			
Sales of property, plant and equipment	186	340	1,885
Compulsory loans	(29)	1,932	(3,494)
Additions to investment	(5,341)	(22)	4,949
Additions to property, plant and equipment	(46,439)	(104,829)	(216,977)
Additions to deferred charges	(70,930)	(38,866)	(111,612)
Net cash used in investing activities	(122,553)	(141,445)	(325,249)

(Amounts in thousands of constant Brazilian *reais* as of March 31, 2001, unless otherwise indicated)

	For the year ended December 31,		
	1998	1999	2000
Financing activities:			
Capital increase	—	—	475,350
Redemption of class “B” preferred shares	—	(15,311)	—
Loans repaid	(958,953)	(2,106,723)	(2,219,560)
New loans obtained	1,422,753	1,949,076	1,790,183
Payment of refinanced taxes	(50,410)	(6,530)	(5,010)
Refinancing of taxes	72	—	—
Guarantee deposits	(7,885)	(16,767)	(13,923)
Grant for investment from risk sharing suppliers	—	—	240,125
Dividends paid	(28,548)	(91,122)	(249,520)
Payment of interest on debentures	—	(4,265)	(3,783)
New debentures	—	191,901	—
Net cash provided by (used in) financing activities	377,029	(99,741)	13,862
Net increase in cash and equivalents	280,503	190,880	1,747,347
Cash and equivalents, beginning of the period	139,872	420,375	611,255
Cash and equivalents, end of the period	420,375	611,255	2,358,602
Supplemental cash flow disclosure:			
Cash paid during the year for—			
Income taxes	2,501	24,115	237,241
Interest	69,318	89,091	87,655
	71,819	113,206	324,896
Noncash transactions—			
Conversion of debentures to capital	—	—	22,829
Lease of assets	871	20,844	21,744

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

a.2. In U.S. GAAP

	For the year ended December 31,		
	1998	1999	2000
Operating activities:			
Net income for the year	208,199	491,982	539,611
Adjustments to reconcile net income to net cash provided by operating activities—			
Depreciation and amortization	56,703	69,730	70,007
Allowance for doubtful accounts	10,543	19,199	6,506
Gain on permanent asset disposals	5,335	2,825	1,983
Write-off related to tooling of EMB 120	—	40,432	—
Write-off of capitalized interest	—	(4,444)	—
Provision for losses	725	9,352	13,883
Reversal of deferred income	(1,069)	(912)	(12)
Deferred income taxes and social contribution tax	(4,752)	(2,912)	22,599
Reduction of penalties—INSS refinanced	(6,258)	—	—
Interest on loans, tax installments and debentures	62,090	113,591	86,497
Reserve for (Reversal of) contingencies	(2,820)	7,019	16,597
Reversal of reserve for losses on contracts	(4,040)	(18,682)	—
Monetary and exchange variation on loans, tax installments and debentures	(17,987)	49,583	(23,396)
Provision for realization of value-added tax credits	(5,789)	—	—
Equity in unconsolidated subsidiary	(218)	283	(1,493)
Translation adjustments on consolidated foreign investments	6,048	34,255	(9,190)
Cumulative translation adjustments	23,913	86,635	18,592
Minority Participation	—	—	11,424
Write-off investments	—	—	68
	330,623	897,936	753,676
Changes in current assets and liabilities—			
Accounts receivable	(103,636)	(70,723)	(72,931)
Inventories	(388,778)	(523,305)	315,040
Prepaid expenses	126	746	(7,199)
Deferred and recoverable taxes	(11,210)	(8,654)	24,641
Other receivables	(15,949)	(12,123)	3,786
Suppliers	78,907	66,015	129,112
Accrued taxes on income	3,307	25,625	49,973
Accrued liabilities	45,248	77,418	229,285
Customers advances	(425)	203,901	141,979
Taxes and social charges payable	(5,979)	50,676	73,866
Other	17,605	25,376	72,981
	(380,784)	(165,048)	960,533

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

	For the year ended December 31,		
	1998	1999	2000
Changes in noncurrent assets and liabilities—			
Accounts receivable	(23,915)	(337,692)	331,993
Recoverable taxes	2,264	(7,498)	(754)
Other receivables	(4,789)	11,584	20,606
Suppliers	(4,477)	(6,038)	—
Accounts payable	(648)	27,163	1,155
Customers advances	55,290	67,044	(63,639)
Deferred income	(299)	—	(41)
Accrued liabilities	(37,741)	(46,865)	(30,801)
Tax payable	711	—	(3,347)
Minority Participation	—	—	8,977
	(13,604)	(292,302)	264,149
Net cash provided by (used in) operating activities	(63,765)	440,586	1,978,358
Investing activities:			
Sales of property, plant and equipment	186	340	1,885
Compulsory loans	(29)	1,932	(3,495)
Additions to investment	(5,341)	(22)	(864)
Additions to property, plant and equipment	(56,096)	(151,561)	(228,403)
Additions to deferred charges	(27)	(654)	(1,162)
Net cash used in investing activities	(61,307)	(149,965)	(232,039)
Financing activities:			
Capital increase	—	—	462,514
Redemption of class ''B'' shares	—	(15,311)	—
Loans repaid	(958,953)	(2,106,723)	(2,219,560)
New loans obtained	1,422,753	1,949,076	1,790,183
Payment of refinanced taxes	(50,410)	(6,530)	(5,010)
Refinancing of taxes	72	—	—
Guarantee deposits	(7,885)	(16,767)	(13,923)
Dividends paid	—	(91,122)	(249,520)
Payment of interest on debentures	—	(4,265)	(3,783)
New debentures	—	191,901	—
Grant for investments from risk sharing suppliers	—	—	240,125
Net cash provided by (used in) financing activities	405,577	(99,741)	1,026
Net increase in cash and equivalents	280,503	190,880	1,747,347
Cash and equivalents, beginning of the period	139,872	420,375	611,255
Cash and equivalents, end of the period	420,375	611,255	2,358,602

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

	For the year ended December 31,		
	1998	1999	2000
Supplemental cash flow disclosure:			
Cash paid during the year for—			
Income taxes	2,501	24,115	237,241
Interest	69,318	89,091	87,655
	71,819	113,206	324,896
Noncash transactions—			
Conversion of debentures to capital	—	—	22,829
Lease of assets	871	20,844	21,744

b. Segment Report

The Company operates in four major segments: regional aircraft manufacturing, defense aircraft manufacturing, corporate aircraft manufacturing and other related businesses.

Products

Regional Aircraft

In the regional airline market, the Company offers products in the 21-40 seat market segment, represented by the EMB 120 Brasília, a 30-seat turboprop. Also in this market segment, the Company introduced, on May 12, 1998, the ERJ 135, a 37-seat regional jet. In the 41-60 seat market segment, the Company is present with its ERJ 145, a 50-seat regional jet. In addition the Company is developing a new regional jet as part of the ERJ 135/140/145 regional jet family, the 44 seat ERJ 140, which the Company expects to deliver in the second half of 2001. The Company relies on a limited number of customers for a substantial portion of its total net sales. The Company's largest customers are Continental Express and American Eagle.

Defense Aircraft

In the defense market segment, the Company has the following products:

- The EMB 312, in two platforms, the basic Tucano and the Super-Tucano—EMB 314. Also, the Super Tucano is being used as a platform of the AL-X, aircraft developed for the Brazilian Air Force.
- The AM-X, an advanced ground attack jet, developed and manufactured through an industrial cooperation agreement between Brazil and Italy.
- The EMB 145 AEW&C, an Airborne Early Warning and Control aircraft, the EMB 145 RS, a Remote Sensing aircraft in development process with the objective of assisting the SIVAM Program and the EMB 145 MP, a Marine Patrol aircraft, based on the ERJ 145 regional jet.

The Brazilian Air Force is the largest customer of the Company's defense aircraft products.

A decrease in defense spending by the Brazilian government due to defense spending cuts and general budgetary constraints or other facts could materially adversely affect the Company's defense sales and defense research and development.

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

Corporate Aircraft

The Company is developing a new line of corporate jets, the Legacy, based on the ERJ 135 regional jet. The Legacy is being the marketed by the Company to businesses, including fractional ownership companies.

Other Related Businesses

The Company provides after-sales customer support services and manufacture and market spare parts for its aircraft. Activities in this segment include the sale of spare parts, maintenance and repair, training and other product support services. In addition, the Company provides structural parts and mechanical and hydraulic systems to Sikorsky Corporation for its production of helicopters. The Company also manufactures, on a limited basis and upon customer request, general aviation propeller aircraft, such as executive aircraft and crop dusters.

The Company has entered into a joint venture with Liebherr International AG to develop and manufacture landing gear and high precision hydraulic equipment and to provide related services for the Company and clients around the world. On November 26, 1999, the Company formed a new subsidiary, Embraer Liebherr Equipamentos do Brasil S.A., also known as ELEB, to which were transferred all of the landing gear manufacturing activities, the corresponding employees and some liabilities related to those activities on December 1, 1999. The Company has retained some liabilities and obligations related to the landing gear manufacturing activities that were transferred to ELEB.

On May 22, 2000, Liebherr International AG, acting in coordination with its subsidiary, Liebherr Aerospace Andenberg GmbH, a German company, and through its Brazilian affiliate, Liebherr Participações Brasil Ltda., subscribed for 40% of the capital stock of ELEB. In the agreement with Liebherr International AG, the Company has agreed to provide ELEB with loans in the total amount of R$3.9 million at an annual interest rate equal to 12%, for working capital and investment purposes related to the activities to be performed by ELEB. The Company has also agreed not to compete with ELEB's business. Liebherr Aerospace, currently a Company risk-sharing partner responsible for designing, developing and manufacturing the landing gear assemblies for the new ERJ 170/190 regional jet family, is part of a German group active in diverse activities including civil construction projects, machine and tools manufacturing and development of aerospace technology.

Significant Customers

During 1998, 1999 and 2000, the Company had significant customers which each represented more than 10% of sales for the respective year. The percentages below show the percentage of total net sales for a particular customer.

	%		
	1998	**1999**	**2000**
Regional:			
Continental Express	29	22	28
American Eagle	—	26	15
Rio Sul—Brazil	21	—	—
Defense:			
Brazilian Air Force	11	—	—

The information in the following tables is derived directly from the segments' internal and consolidated statements of income reports used for corporate management purposes.

	Net sales by geographic area		
	Year ended December 31,		
	1998	1999	2000
	(in millions of reais)		
The Americas without Brazil	1,339.2	2,610.3	2,806.6
Regional	1,219.5	2,399.7	2,562.9
Defense	—	6.0	—
Corporate	—	—	52.9
Other related businesses	119.7	204.6	190.8
Brazil	370.3	514.9	184.7
Regional	126.1	114.6	—
Defense	195.5	233.6	129.8
Other related businesses	48.7	166.7	54.9
Europe	349.5	923.9	2,299.6
Regional	303.1	852.6	2,141.9
Defense	5.2	—	54.4
Other related businesses	41.2	71.3	103.3
Others	45.6	10.7	126.6
Regional	—	—	109.3
Defense	36.6	—	—
Other related businesses	9.0	10.7	17.3
Total	2,104.6	4,059.8	5,417.5

	Operating income		
	Year ended December 31,		
	1998	1999	2000
	(in millions of reais)		
Net sales	2,104.6	4,059.8	5,417.5
Regional	1,648.7	3,366.9	4,814.1
Defense	237.3	239.6	184.2
Corporate	—	—	52.9
Other related businesses	218.6	453.3	366.3
Cost of sales	(1,564.3)	(2,656.4)	(3,916.0)
Regional	(1,262.9)	(2,255.2)	(3,524.5)
Defense	(167.7)	(211.3)	(183.9)
Corporate	—	—	(36.7)
Other related businesses	(133.7)	(189.9)	(170.9)
Gross profit	540.3	1,403.4	1,501.5
Regional	385.8	1,111.7	1,289.6
Defense	69.6	28.3	0.3
Corporate	—	—	16.2
Other related businesses	84.9	263.4	195.4
Operating expenses	(303.4)	(402.0)	(658.3)
Regional	(92.9)	(107.5)	(203.2)
Defense	(20.9)	(16.5)	(31.5)
Corporate	—	—	(0.3)
Other related businesses	(112.7)	(122.2)	(134.4)
Unallocated corporate expenses	(76.9)	(155.8)	(288.9)
Operating income	236.9	1,001.4	843.2

	Fixed assets		
	At December 31,		
	1998	1999	2000
	(in millions of reais)		
Regional	29.9	30.7	66.1
Defense	55.4	119.8	127.4
Other related businesses	5.2	6.0	12.9
Unallocated	370.4	365.3	467.5
Total	460.9	521.8	673.9

	Receivables		
	At December 31,		
	1998	1999	2000
	(in millions of reais)		
Regional	82.9	451.8	161.2
Defense	65.2	63.4	44.5
Other related businesses	95.0	136.3	186.7
Total	243.1	651.5	392.4

	Customers advances		
	At December 31,		
	1998	1999	2000
	(in millions of reais)		
Regional	292.5	573.8	650.9
Defense	72.4	45.0	40.1
Corporate	—	—	21.6
Other related businesses	28.4	45.5	30.0
Total	393.3	664.3	742.6

	Additions to deferred charges		
	At December 31,		
	1998	1999	2000
	(in millions of reais)		
Regional	66.1	37.0	95.4
Corporate	—	—	14.5
Other related businesses	4.8	1.9	1.7
Total	70.9	38.9	111.6

	Amortization of deferred charges		
	Year ended December 31,		
	1998	1999	2000
	(in millions of reais)		
Regional	104.1	133.2	155.7
Other related businesses	0.1	1.5	1.1
Total	104.2	134.7	156.8

c. Stock options

Information concerning stock options to management and employees is presented in the following table:

	Shares
Available for grant at April 17, 1998	25,000,000
Granted:	
1998	7,250,000
1999	5,400,000
2000	5,250,000
Available for grant at the end of the year	7,100,000

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

Option conditions on December 31, 2000:

Grant date	Exercisable date	Expiration date	Exercise price	Number of outstanding stock options
May 1998	May 2001	May 2005	0.75/1.65/1.07	4,515,000
November 1998	November 2001	November 2005	1.65	600,000
May 1998 and 1999	May 2002	May 2005 and 2006	0.75/1.65/1.07/1.65	1,245,000
November 1998 and 1999	November 2002	November 2005 and 2006	1.65/5.22/1.65	1,640,000
May 1998, 1999 and 2000	May 2003	May 2005 and 2006	0.75/1.65/1.07/8.11/1.65	2,535,000
November 1998, 1999 and 2000	November 2003	November 2005 and 2006	1.65/5.22/1.65/13.70	1,730,000
May 1999 and 2000	May 2004	May 2006	1.65/8.11	2,425,000
November 1999 and 2000	November 2004	November 2006	5.22/1.65/13.70	1,110,000
May 2000	May 2005	May 2007	8.11	1,580,000
November 2000	November 2005	November 2007	13.70	520,000
Total outstanding stock options				17,900,000

The Company applies APB Opinion No. 25 and related interpretations in accounting for its stock option plan. Accordingly, compensation cost has been recognized for grants of stock options based on market prices and grant prices at the date of grant. The options granted were for past service. Had compensation cost for the Company's stock-based compensation plans been determined in accordance with the provisions of SFAS No. 123 ''Accounting for Stock-based Compensation'', the Company's U.S. GAAP net income and earnings per share would have been changed to the pro forma amounts indicated below:

	1998	1999	2000
Net income under U.S. GAAP—as reported	208,199	491,982	539,611
Net income under U.S. GAAP—pro forma	192,993	470,789	480,330
Basic earnings per common share—as reported	0.41	0.97	1.00
Basic earnings per common share—pro forma	0.38	0.93	0.87
Diluted earnings per common share—as reported	0.41	0.83	0.85
Diluted earnings per common share—pro forma	0.38	0.79	0.75
Basic earnings per preferred share—as reported	0.45	1.07	1.10
Basic earnings per preferred share—pro forma	0.41	1.01	0.96
Diluted earnings per preferred share—as reported	0.44	0.91	0.93
Diluted earnings per preferred share—pro forma	0.41	0.85	0.82

The pro forma amounts reflected above are not representative of the effects on reported net income in future years because additional awards may be made each year.

The Company used the following assumptions to estimate the fair value of the stock options:

- The projected price/earnings ratio of publicly traded companies in the aerospace industry at the time of issuance of the stock option was applied to the Company's internally projected net income through the date of exercise of each option.
- Projected dividends for the years prior to the exercise date of the stock options were discounted and deducted from the projected share price. The discount rate used was 12.5%, which includes 5.9% as an average risk free rate, plus 6.6% for Brazil country risk.
- Past volatility of the Company's share price was not considered because management believes it is not representative of the future market price of the Company's shares due to the stabilization of the Company's earnings.

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

d. Operating Leases

Operating leases consisted of the following:

	At December 31,		
	1998	1999	2000
Leased aircraft at cost (net of accumulated depreciation of R$7,644, R$17,872 and R$25,367)	24,589	64,569	111,579
Less—valuation allowance	(3,198)	(7,163)	(6,223)
	21,391	57,406	105,356

Scheduled receipts on leases are as follows:

Year	At December 31, 2000
2001	11,769
2002	9,864
2003	6,909
2004	5,267
2005	3,327
Thereafter	7,363

Transactions consist of operating leases of ten used turboprop aircraft, EMB 120 Brasília, which were received under special circumstances from customers.

The valuation allowance is recognized based on the fair value of the aircraft less its carrying amount.

e. New Accounting Pronouncements

SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities"

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 133. SFAS No. 133 is effective for transactions entered into after January 1, 2000. SFAS No. 133 requires that all derivative instruments be recorded on the balance sheet at fair value. Changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income, depending on whether a derivative is designated as part of hedge transaction and type of hedge transaction. The ineffective portion of all hedges will be recognized in earnings. The Company has initially assessed that its current derivative instruments do not qualify for being designated as hedges mainly because the Company has no written documentation as how to measure the ineffectiveness of such instruments as well as because certain of the derivatives carried by the Company do not match their intended hedged items in terms of notional amount and settlement date. The Company accordingly expects to record income of R$8,229.6 related to the deferred gains on foreign currency options, considered to be free standing derivatives. Losses have already been recognized prior to adoption of SFAS No 133.

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

SAB No. 101, "Views on Selected Revenue Recognition Issues"

In December 1999, the staff of the Securities and Exchange Commission issued Staff Accounting Bulletin (SAB) No. 101, "Views on Selected Revenue Recognition Issues" (SAB No. 101), which sets forth the staff's views in applying generally accepted accounting principles to selected revenue recognition issues. SAB No. 101 is effective September of 2000 and had no impact to the Company.

FASB Interpretation No. 44, "Accounting for Certain Transactions involving Stock Compensation"

In March 2000, the Financial Accounting Standards Board issued FASB Interpretation No. 44 (FIN No. 44). FIN No. 44 is effective July 1, 2000 and should also be applied prospectively to certain events after December 15, 1998 but prior to July 1, 2000. FIN No. 44 clarifies the application of APB Opinion No. 25—"Accounting for Stock Issued to Employees" for certain issues but had no impact on the Company.

f. Deferred Income Taxes

	At December 31,		
	1998	1999	2000
Valuation reserve for deferred tax assets under U.S. GAAP:			
Beginning balance	287,754	222.424	—
Additions to reserve for tax loss carryforward	339	—	—
Offset taxable income for the year	—	(22,242)	—
Reduction of reserve to reflect expected realization of loss carryforward	(27,663)	(136,185)	—
Realization of timing differences	(38,006)	(63,997)	—
Ending balance	222,424	—	—

g. Changes in accounting policy to December 1999

During 1999 the Company made a change in accounting for recognition of deferred tax assets on tax loss carryforwards. Prior to 1999, Brazilian GAAP allowed recognition of the assets only when it was reasonably assured that the assets would be recovered by taxes payable. Accordingly, the Company used internal studies and projections for taxes payable in the three years following the date of determination as a basis to recognize deferred tax assets. As from January 1, 1999, the Company adopted the criteria set forth in a new pronouncement from the CVM (CVM Pronouncement No. 273) and IBRACON of recognizing deferred tax assets on tax loss carryforwards when realization, based on internal studies and projections, is more likely than not. The cumulative effect of this change in accounting for the year ended December 31, 1999 was R$96,076. The cumulative effects of recognizing the deferred tax assets for the year ended December 31, 1998 was R$37,343. The following table summarizes the pro-forma net earnings amounts for the year ended presented (pro-forma amounts assuming the change in application of accounting principles applied retroactively):

	Year ended December 31,		
	1998	1999	2000
Income (loss) as reported in the accompanying financial statements under Brazilian GAAP	108,778	509,280	512,665
Additional deferred tax asset	37,343	—	—
Pro-forma net income under Brazilian GAAP	146,121	509,280	512,665

(Amounts in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

This new accounting policy had already been adopted by the Company in preparing the reconciliation of its financial statements in U.S. GAAP. Accordingly, there is no impact in net income in accordance with U.S. GAAP.

31. Balances in Foreign Currency

The Company and its subsidiaries valued their foreign currency-denominated assets and liabilities, represented mainly by U.S. dollar-denominated assets and liabilities, at the exchange rate effective at December 31, 2000, of R$1.9554 per U.S. dollar.

	December 31, 2000
Assets:	
Current	1,083,925
Noncurrent	108,876
Total assets	1,192,801
Liabilities:	
Current—	
Noninterest bearing	1,291,433
Interest bearing	701,881
Long-term—	
Noninterest bearing	445,603
Interest bearing	86,716
Total liabilities	2,525,633
Net liability position in foreign currency	1,332,832

32. World Trade Organization—WTO

In April 1999 the World Trade Organization, or 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. The WTO ruled that Brazil must withdraw the prohibited portions of its export subsidies for regional aircraft under the ProEx program and recommended that it conform the ProEx program to the WTO rules by November 18, 1999. On November 19, 1999, the Brazilian and Canadian governments presented to the dispute resolution body of the WTO the modifications that they made to bring their respective programs into compliance with the WTO rulings. Both countries then declared that the other's modifications were unsatisfactory and did not comply with the WTO rulings.

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 the customers of the Company prior to November 18, 1999 were prohibited export subsidies. The WTO also concluded that the amended version of the ProEx program still decreased effective interest rates for regional aircraft to below commercial market levels and thus continued to provide a prohibited export subsidy. The Brazilian government publicly announced that it intends to honor its contractual commitments to the Company's customers. However, the Company cannot provide assurances that the Brazilian government will, in fact, honor its contractual commitments to the customers, or that, if it does, its trade relations with Canada or other countries will not suffer.

The Brazilian government also announced that it would further amend the ProEx program to provide that any ProEx payments would not decrease the effective interest rate below the commercial interest reference rate permitted by the WTO regulations without proof that the actual market interest rate is lower than the commercial interest reference rate. Canada is challenging the Brazilian government's interpretation of the scope of application of the WTO's effective interest rate restrictions.

A substantial percentage of the Company's customers benefit from the ProEx program. A reduction of existing commitments under the ProEx program could cause the Company to reduce prices or otherwise compensate the customers or could result in the cancellation of firm orders in backlog, which could reduce the sales and profitability of the Company. If the ProEx program or another similar program is not available in the future, or if its terms are substantially reduced, the customers' financing costs could be higher and the cost-competitiveness of the Company in the regional jet market could decrease.

As a result of Brazil's decision to maintain its contractual commitments under the ProEx program, the WTO dispute settlement body granted Canada 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. The Company cannot predict what form, if any, these sanctions will take and whether any such sanctions will adversely affect its business. In addition, the Canadian government has 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. Brazil is challenging this financing before the WTO. If the WTO determines that these or any other government-sponsored financing that benefits the Company's competitors is permissible, the cost-competitiveness of the Company's aircraft in the regional jet market would suffer, which could cause the Company's customers to reduce their orders or fail to exercise their options.

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EMBRAER-EMPRESA BRASILEIRA DE AERONÁUTICA S.A.

CONSOLIDATED BALANCE SHEETS AT DECEMBER 31, 2000 AND MARCH 31, 2001

(Expressed in thousands of constant Brazilian *reais* as of March 31, 2001)

A S S E T S

	Notes	December 31, 2000	March 31, 2001 (unaudited)
CURRENT ASSETS:			
Cash and cash equivalents		2,358,602	2,527,916
Trade accounts receivable		347,336	510,781
Allowance for doubtful accounts		(28,853)	(32,787)
Recoverable taxes		8,868	15,944
Other receivables		40,788	50,798
Inventories	(3)	1,210,199	1,489,405
Prepaid expenses		17,671	19,461
Deferred income taxes	(23)	230,725	229,204
Total current assets		4,185,336	4,810,722
NONCURRENT ASSETS:			
Trade accounts receivable		45,092	51,250
Recoverable taxes		4,569	510
Compulsory loans, guarantee and other deposits		11,200	13,319
Other receivables		67,691	77,203
Deferred income taxes	(23)	171,377	170,840
Total noncurrent assets		299,929	313,122
PERMANENT ASSETS:			
Investments	(4)	8,229	8,955
Property, plant and equipment	(5)	673,923	710,212
Deferred charges	(6)	367,010	374,507
Total permanent assets		1,049,162	1,093,674
Total assets		5,534,427	6,217,518

The accompanying notes are an integral part of these balance sheets.

EMBRAER-EMPRESA BRASILEIRA DE AERONÁUTICA S.A.

CONSOLIDATED BALANCE SHEETS AT DECEMBER 31, 2000 AND MARCH 31, 2001

(Expressed in thousands of constant Brazilian *reais* as of March 31, 2001)

LIABILITIES AND SHAREHOLDERS' EQUITY

	Notes	December 31, 2000	March31, 2001 (unaudited)
CURRENT LIABILITIES:			
Loans	(8)	726,922	734,212
Suppliers	(7)	528,576	946,945
Accounts payable	(10)	128,288	147,300
Customers' advances	(9)	581,554	643,806
Taxes and social charges payable	(11)	151,806	170,463
Accrued taxes on income		79,155	74,894
Dealers and sales agents		1,278	2,186
Accrued liabilities	(12)	363,889	375,961
Dividends	(13)	149,853	103,315
Accrued interest on debentures	(14)	1,823	2,748
Deferred income tax	(23)	1,360	1,262
Total current liabilities		2,714,504	3,203,092
LONG-TERM LIABILITIES:			
Loans	(8)	180,026	173,946
Accounts payable	(10)	284,564	320,079
Customers' advances	(9)	161,040	176,249
Long-term portion of refinanced taxes	(11)	53,277	51,778
Accrued liabilities	(12)	28,481	28,614
Debentures	(14)	180,200	181,655
Deferred income tax	(23)	149,849	139,688
Total long-term liabilities		1,037,437	1,072,009
DEFERRED INCOME		415	449
MINORITY INTEREST		20,401	20,586
SHAREHOLDERS' EQUITY:	(15)		
Capital		1,205,092	1,205,092
Capital reserves		32,156	41,417
Income reserves		524,422	524,422
Retained earnings		—	150,451
Total shareholders' equity		1,761,670	1,921,382
Total liabilities and shareholders' equity		5,534,427	6,217,518

The accompanying notes are an integral part of these balance sheets.

EMBRAER-EMPRESA BRASILEIRA DE AERONÁUTICA S.A.

UNAUDITED CONSOLIDATED STATEMENTS OF INCOME FOR THE THREE MONTHS ENDED MARCH 31, 2000 AND 2001

(Expressed in thousands of constant Brazilian *reais* as of March 31, 2001, except for income per share)

	Notes	2000	2001
SALES:			
Gross sales—			
Domestic market		23,925	40,121
Foreign market		1,137,984	1,531,362
Sales taxes		(2,603)	(3,341)
Other sales deductions		(19,193)	(29,554)
Net sales		1,140,113	1,538,588
COST OF SALES		(847,596)	(966,399)
Gross profit		292,517	572,189
OPERATING EXPENSES:			
Administrative		(32,999)	(37,554)
Selling		(72,157)	(115,862)
Other expenses, net	(20)	(22,802)	(12,980)
Equity in unconsolidated subsidiary		135	—
Employee profit sharing	(18)	(6,469)	(10,485)
Income from operations before financial income (expenses)		158,225	395,308
FINANCIAL INCOME (EXPENSES):			
Interest expenses		(49,152)	(30,501)
Interest income		15,041	51,579
Monetary and exchange variations, net	(19)	37,428	(143,385)
Income from operations after financial income (expenses)		161,542	273,001
NONOPERATING INCOME (EXPENSE), NET		304	(5,100)
INCOME BEFORE INCOME TAX		161,846	267,901
INCOME TAX PROVISION	(23)	(67,712)	(76,113)
INCOME AFTER TAXES		94,134	191,788
MINORITY INTEREST		—	107
NET INCOME		94,134	191,895
INCOME PER SHARE OUTSTANDING AT END OF PERIOD, IN BRAZILIAN REAIS		0.20	0.35

The accompanying notes are an integral part of these financial statements.

EMBRAER-EMPRESA BRASILEIRA DE AERONÁUTICA S.A.

UNAUDITED CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY FOR THE THREE MONTHS ENDED MARCH 31, 2001

(Expressed in thousands of constant Brazilian *reais* as of March 31, 2001)

			Income Reserve			
	Capital	Capital reserves	Legal reserve	Reserve for investment and working capital	Retained earnings	Total
BALANCE ON DECEMBER 31, 2000	1,205,092	32,156	67,521	456,901	—	1,761,670
Fiscal incentive	—	9,261	—	—	—	9,261
Net income	—	—	—	—	191,895	191,895
Deferred income taxes on monetary restatement of shareholders' equity	—	—	—	—	(7,401)	(7,401)
Interest on capital	—	—	—	—	(34,043)	(34,043)
BALANCE ON MARCH 31, 2001	1,205,092	41,417	67,521	456,901	150,451	1,921,382

The accompanying notes are an integral part of these financial statements.

EMBRAER-EMPRESA BRASILEIRA DE AERONÁUTICA S.A.

UNAUDITED CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION FOR THE THREE MONTHS ENDED MARCH 31, 2000 AND 2001

(Expressed in thousands of constant Brazilian *reais* as of March 31, 2001)

	2000	2001
SOURCES OF FUNDS:		
Provided by operations—		
Net income	94,134	191,895
Items not affecting working capital—		
Depreciation	14,958	20,278
Amortization of deferred charges	36,170	39,779
Net book value of permanent asset disposals	955	62
Interest on long-term assets and liabilities added to principal, net	618	(739)
Net monetary and exchange variations on long-term items	(1,211)	37,512
Translation adjustment on consolidated foreign investments	4,650	(15,411)
Provision for (reversal of) losses	(170)	10,515
Reversal of deferred income	(20)	(3)
Long term deferred income and social contribution taxes	(6,594)	(18,706)
Equity in unconsolidated subsidiary	(135)	—
Reserve for contingencies	13	405
Minority interest	—	107
Funds provided by operations	143,368	265,694
From third parties—		
Increase in long-term liabilities—		
Customers' advances	93,492	31,767
Loans	342	1,517
Other liabilities	30,963	10,269
Reduction of long term accounts receivable	35,071	3,344
Funds provided by third parties	159,868	46,897
Total sources	303,236	312,591
APPLICATIONS OF FUNDS:		
Increase in noncurrent assets	130,595	7,081
Property, plant and equipment	23,914	43,428
Deferred charges	8,086	47,189
Transfer to current liabilities—		
Loans	8,891	10,756
Customers' advances	80,508	31,153
Other liabilities	6,233	2,143
Interest on capital	21,557	34,043
Total applications	279,784	175,793
INCREASE IN WORKING CAPITAL	23,452	136,798
WORKING CAPITAL—END OF PERIOD:		
Current assets	2,613,229	4,810,722
Current liabilities	2,332,371	3,203,092
	280,858	1,607,630
WORKING CAPITAL—BEGINNING OF PERIOD	257,406	1,470,832
INCREASE IN WORKING CAPITAL	23,452	136,798

The accompanying notes are an integral part of these financial statements.

EMBRAER-EMPRESA BRASILEIRA DE AERONÁUTICA S.A.

CONDENSED NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2000 AND MARCH 31, 2000 AND 2001 INCLUDING UNAUDITED DATA AS OF AND FOR THE THREE MONTHS ENDED IN MARCH 31, 2000 AND 2001

(Expressed in thousands of constant Brazilian *reais* as of March 31, 2001, unless otherwise indicated)

1. Operations

Embraer-Empresa Brasileira de Aeronáutica S.A. (the ''Company'') is engaged in the design, development, production and marketing of a range of jet and turboprop aircraft for regional airline and defense use, of light reciprocating and turboprop aircraft for general aviation, corporate and agricultural uses and of aviation-related structural parts and mechanical and hydraulic systems. In addition, the Company is developing a new line of corporate jets based on one of its regional jets.

2. Basis of Presentation of Financial Statements

a. Presentation of Financial Statements

The financial statements were prepared in accordance with generally accepted accounting principles in Brazil (''Brazilian GAAP'') and additional regulations of the ''Comissão de Valores Mobiliários'', the Brazilian Securities Commission (the ''CVM''), and this English language translation is provided for the convenience of readers outside Brazil.

Certain reclassifications and changes in terminology have been made in relation to the Company's consolidated financial statements previously issued, and the explanatory notes have been modified in order to conform more closely to reporting practices in the United States.

The condensed consolidated interim financial statements included in this report have been prepared by the Company without audit. In the opinion of management, all adjustments necessary for a fair presentation are reflected in the interim financial statements. Such adjustments are of a normal and recurring nature. The results of operations for the period ended March 31, 2001 are not necessarily indicative of the operating results for the full year. The interim financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's 2000 Annual Report.

Certain accounting practices applied by the Company and its subsidiaries that conform with generally accepted accounting principles in Brazil may not conform with generally accepted accounting principles in other countries.

b. Consolidation Principles

The financial statements include the accounts of the Company and the following subsidiaries: Embraer Aircraft Corporation—EAC, Embraer Aviation International SAS—EAI, Indústria Aeronáutica Neiva S.A.—NEIVA, Embraer Finance Ltd.—EFL, ELEB—Embraer—Liebherr Equipamentos do Brasil S.A., Embraer Services Inc.—ESI, Trumpeter Inc., Embraer Aviation Europe SAS—EAE, Embraer Australia PTY Ltd.—EAL, Embraer Credit Ltd.—ECL and Embraer Europe SARL—EES.

The financial statements of subsidiaries based abroad are prepared according to accounting practices compatible with those used by the Company, and are translated into reais at the exchange rates in effect at the balance sheet dates.

Intercompany balances transactions and unrealized profits are eliminated in consolidation.

(Expressed in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

Investments in affiliates in which the Company does not have control are accounted for under the equity method.

The reconciliation between the amounts reported by the Company in its individual financial statements adjusted for inflation, not presented herein, and the consolidated statements is as follows:

	Net income for the three months ended March 31,		Shareholders' equity at	
	2000	2001	December 31, 2000	March 31, 2001
Company, as adjusted	98,544	196,929	1,814,040	1,978,786
Unrealized profit (*)	(4,410)	(5,034)	(52,370)	(57,404)
Consolidated	94,134	191,895	1,761,670	1,921,382

(*) Unrealized profit arises from sales by the Company to its subsidiaries, and also among the subsidiaries, of spare parts and marketing rights, and is eliminated in consolidation.

c. *Requirements of Brazilian Legislation*

The principal criteria adopted to prepare the fully indexed consolidated financial statements for the year ended December 31, 2000 and for the three months ended March 31, 2000 and 2001, were as follows:

c.1. Inflation Restatement Index

The consolidated financial statements as of and for the year ended December 31, 2000 and as of and for the three months ended March 31, 2000 and 2001 were indexed and expressed in currency of constant purchasing power of March 31, 2001 by using the monthly average values of the ''Índice Geral de Preços de Mercado'' (the General Prices Index—Market or the ''IGP-M'') of the Fundação Getúlio Vargas. Inflation rates for the year ended December 31, 2000 and the three months ended March 31, 2000 and 2001, as measured by the IGP-M, were as follows:

Period	Inflation rate (%)
Three months ended March 31, 2000	1.8
Year ended December 31, 2000	9.9
Three months ended March 31, 2001	1.4

c.2. Deferred Income Tax Effects of Indexation Adjustments

As a result of legislation mandating the discontinuation of the indexation system for Brazilian corporate law and most fiscal purposes, as from January 1, 1996, the indexation of assets and liabilities for financial reporting purposes used in these financial statements is not permitted for tax purposes. Accordingly, a deferred tax liability arises from the excess of net assets shown for financial reporting purposes over the tax basis of these net assets. The Company recognized additional deferred tax liability of R$99,509 as of December 31, 2000 and R$93,833 as of March 31 (see Note 23).

(Expressed in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

The reconciliation between the shareholders' equity as of December 31, 2000 and March 31, 2001 and net income for the three months ended March 31, 2000 and 2001 under Brazilian corporate law accounting and these financial statements, which includes the effects of full indexation until March 31, 2001, as described above, is as follows:

	Net income for the three months ended March 31,		Shareholders' equity at	
	2000	2001	December 31, 2000	March 31, 2001
As reported under the corporate law method:				
Consolidated financial statements	97,559	218,723	1,538,726	1,732,744
Monetary restatement of opening balances	9,359	—	21,851	—
Opening balances monetarily restated	106,918	218,723	1,560,577	1,732,744
Monetary restatement of:				
Other accounts receivable	4	—	—	—
Inventories	(6,025)	(10,854)	72,711	61,857
Prepaid expenses	(329)	89	623	712
Customers' advances	61	(28)	(6,480)	(6,508)
Shareholders' equity	(13,437)	(21,769)	—	—
Property, plant and equipment	2,739	1,266	143,951	145,217
Deferred charges	(6,179)	(8,339)	86,053	77,714
Investments	2	—	2	2
Other accounts payable	1	—	—	—
Minority interest	—	1,169	(4,185)	(3,016)
Deferred income tax effect of monetary restatement adjustment	3,220	13,072	(99,509)	(93,833)
Additional deferred income tax under constant currency method	7,159	(1,434)	7,927	6,493
As reported in the accompanying financial statements	94,134	191,895	1,761,670	1,921,382

c.3. New Pronouncements

On March 22, 2001, the Federal Accounting Council (Conselho Federal de Contabilidade—CFC) issued a new technical pronouncement—CFC n° 900 changing the generally accepted accounting principles (GAAP). This new pronouncement requires the preparation of financial statements under constant currency method, (price-level adjusted), only when the cumulative inflation rates approximate or exceed 100% over a three-year period. The inflation rates must be computed based on ''Índice Geral de Preços de Mercado'' (the General Prices Index—Market or the ''IGP-M'') of the Fundação Getúlio Vargas. The Company will continue preparing its financial statements under constant currency method, while the accounting profession, through the Brazilian Institute of Accountants (IBRACON) and the Federal Accounting Council (Conselho Federal de Contabilidade—CFC), does not define a guideline for the transition and comparability of financial statements prepared under constant currency and corporate law method.

(Expressed in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

3. Inventories

	At December 31, 2000	At March 31, 2001
Finished goods	61,873	119,851
Work-in-process	419,983	513,658
Raw materials	590,558	685,900
Used aircraft for resale	1,170	5,287
Supplies	2,279	1,880
Inventory in transit	106,790	126,005
Advances to suppliers	27,546	36,824
	1,210,199	1,489,405

Inventories, when applicable, were reduced to their replacement cost (raw materials) and net realizable value (work-in-process and finished goods), as follows:

- Allowance for reduction to market value—Inventories of work-in-process and finished goods were reduced to net realizable value after deduction for costs, taxes and selling expenses. Inventories of raw materials were reduced to market value based on the inventories' average monetarily restated cost compared with the average cost of replacement.
- Allowance for obsolescence—For items without activity for more than two years, provisions were made for possible losses on excess and obsolete supplies and work-in-process inventories, based on management's estimate of net realizable values.

4. Investments

a. Balances

	At December 31, 2000	At March 31, 2001
Associated company:		
Expressprop LLC. (a)	8,024	8,746
Other	205	209
	8,229	8,955

(a) Embraer owns 25% of the capital stock of this company.

(Expressed in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

b. Relevant Information on Consolidated Subsidiaries

	At March 31, 2001		
	Equity participation —(%)	Shareholders' equity (deficit)	Net income (loss)
Embraer Aircraft Corporation—EAC	100.00	105,656	10,804
Embraer Aviation International—EAI	100.00	5,579	(905)
Indústria Aeronáutica Neiva S.A.—NEIVA	100.00	14,565	(733)
Embraer Finance Ltd.—EFL	100.00	40,023	8,013
ELEB—Embraer Liebherr Equipamentos do Brasil S.A.	59.995	49,549	(1,740)
Embraer Services Inc.—ESI	100.00	17,464	790
Trumpeter Inc.	100.00	8,424	—
Embraer Aviation Europe SAS—EAE	100.00	38	—
Embraer Australia PTY Ltd.—EAL	100.00	3,686	123
Embraer Credit Ltd.—ECL	100.00	(1,929)	(763)
Embraer Europe SARL—EES	100.00	110	95

c. Transactions With Unconsolidated Related Parties

	At December 31, 2000	At March 31, 2001
Brazilian Air Force:		
Current—		
Accounts receivable	46,085	73,091
Customers' advances	35,486	39,441
Accounts payable	6,269	5,390

	For the three months ended March 31,	
	2000	2001
Brazilian Air Force:		
Income (expenses)—		
Sales	16,221	28,348
Bozano group:		
Interest income (expenses)—		
Temporary cash investments	525	—

The Company has engaged in a number of transactions with the Brazilian Air Force and the Bozano Group as shown above. The Company does not engage in transactions or arrangements with any of its affiliates on a basis or terms less favorable to the Company than would be obtained at the time from an unaffiliated third party in arm's-length transactions or other arm's-length arrangements.

(Expressed in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

The Brazilian Government, principally through the Brazilian Air Force, has participated in the development of the Company and plays a key role as:

- A source for funded research and development through technology development institutions such as FINEP (Financiadora de Estudos e Projetos, a Brazilian Government financing agency) and the BNDES (National Economic and Social Development Bank).
- An export support agency through the BNDES.

The Company maintains credit facilities with the BNDES and FINEP of which R$118.3 million and R$24.5 million principal amount, respectively, was outstanding at March 31, 2001. In addition, as described in Note 8, the Company renegotiated reductions in the interest rates on loans from the BNDES. As described in Note 14, in February and March 1999, the Company sold a total of 83,330 debentures with the face amount of R$150.0 million, principally to BNDESPAR (BNDES Participações S.A.—BNDESPAR), a wholly-owned subsidiary of BNDES.

5. Property, Plant and Equipment

	Annual depreciation rate —%	At December 31, 2000			At March 31, 2001		
		Cost	Depreciation	Net	Cost	Depreciation	Net
Land	—	26,103	—	26,103	26,103	—	26,103
Buildings and land improvements	2.08 to 10.00	374,053	153,375	220,678	405,533	157,350	248,183
Installations	3.23 to 10.00	229,199	182,746	46,453	238,603	184,676	53,927
Machinery and equipment	5.88 to 20.00	394,854	271,283	123,571	404,145	276,473	127,672
Furniture and fixtures	10.00 to 20.00	29,235	21,288	7,947	30,415	21,565	8,850
Vehicles	9.09 to 20.00	9,894	6,849	3,045	9,956	6,982	2,974
Aircraft	11.11 to 20.00	133,450	28,095	105,355	145,212	34,036	111,176
Computers and peripherals	20.00	83,438	50,905	32,533	85,705	53,024	32,681
Others	20.00	50,296	10,166	40,130	61,695	14,166	47,529
Construction in progress	—	68,108	—	68,108	51,117	—	51,117
		1,398,630	724,707	673,923	1,458,484	748,272	710,212

On December 30, 1988 and April 30, 1991, the Company recorded revaluations of its operating assets. The remaining balance of these revaluations at December 31, 2000 and March 31, 2001 amounted to R$208,001 and R$203,899, respectively. The corresponding revaluation reserves were used to increase capital and, except for the portion related to real estate, were included in the computation of taxable income for income tax purposes. The depreciation rates of the revalued assets were determined based on the revised estimated useful lives of these assets, in accordance with the independent appraisal reports.

(Expressed in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

6. Deferred Charges

	At December 31, 2000			At March 31, 2001		
	Cost	Amortization	Net	Cost	Amortization	Net
ERJ 135/140/145 (a)	684,661	413,014	271,647	693,481	455,198	238,283
ERJ 170/190	67,580	—	67,580	107,405	—	107,405
EMB 120 Brasília	311,619	309,567	2,052	311,619	309,567	2,052
S-92—Sikorsky Components	24,283	—	24,283	25,108	—	25,108
Others	9,763	8,315	1,448	10,494	8,835	1,659
	1,097,906	730,896	367,010	1,148,107	773,600	374,507

(a) Includes research and development costs for the Legacy, the Company's line of corporate jets.

Deferred charges include the compensation of engineers assigned to the development of each new aircraft, support services, certain production overhead, tooling, and direct labor and materials to construct a prototype of the aircraft or relevant components. Also included are the costs of testing the prototype and subsequent design changes.

The amortization of deferred charges is computed based on the estimated number of aircraft to be produced, for each project, starting when benefits begin to be generated, and is allocated to production costs.

For cancelled projects, or those for which full realization is considered unlikely, the deferred charges are written off or reduced to estimated net realizable value.

ERJ 145

This 50-seat regional jet aircraft 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 in China in November 2000. This aircraft is being operated by regional commercial airlines in Brazil, the United States, Europe and China. As of March 31, 2001, the Company had delivered 316 ERJ 145s, and had 236 firm orders for this aircraft including two firm orders from the defense market. A modified platform of the ERJ 145 is in the development process for use by the Brazilian, Greek and Mexican Government (EMB 145 AEW&C—an Airborne Early Warning and Control aircraft, EMB 145 RS—a Ground Remote Sensing aircraft and EMB 145 MP—a Marine Remote Sensing Aircraft). As of March 31, 2001 the Company had 15 firm orders for such aircraft.

ERJ 140

This is a new 44-seat regional jet aircraft. Over 96% of this aircraft's parts are also used in the ERJ 145 and ERJ 135 models. The ERJ 140 is expected to be available for the market in 2001. As of March 31, 2001, the Company had a backlog of 139 firm orders for this aircraft.

ERJ 135

This 37-seat regional jet aircraft received certification on July 16, 1999, from the Federal Aviation Administration—FAA to operate in the United States, and the certification by the Joint Aviation Authorities—JAA to operate in Europe was in October 1999. As of March 31, 2001, the Company had delivered 78 aircraft, of which two were for the corporate aviation market and one for the Greek government. The Company has 73 firm orders for this aircraft, including two firm orders for the defense market.

In July 2000, the Company introduced its latest product: the Legacy. This aircraft is a derivative of the ERJ 135 and will be offered in two versions: executive and corporate shuttle. As of March 31, 2001, the Company had a backlog of 30 firm orders for this aircraft.

ERJ 170 and ERJ 190

The Company is developing a new family of regional jets with capacities for 70, 98 and 108 passengers, the ERJ 170, ERJ 190-100 and ERJ 190-200, respectively. As of March 31, 2001, the Company had 120 firm orders for these regional jets.

EMB 120 Brasília

This 30-seat regional turboprop aircraft received certification to operate in the United States and Brazil in the second semester of 1985. As of March 31, 2001, the Company had delivered 350 EMB 120 Brasília, including five deliveries for the Brazilian Air Force, and had two firm orders for this aircraft.

The EMB 120 Brasília project was being amortized based on the expected original total number of aircraft to be sold. Due to a reduction in potential sales for this aircraft, in 1997 and 1999 management wrote off R$132,722 and R$50,273, respectively, of deferred charges related to this aircraft model, leaving R$2,052 for the amortization of two aircraft which are in the Company's backlog.

S-92—Sikorsky Components

The Company is in the process of development and production of fuel tank structures and fuel systems and landing gear of the helicopter model S-92 Helibus, to be produced by Sikorsky Corporation (USA).

The research and development costs per aircraft, as of March 31, 2001, as well as the backlog are presented below:

	In thousands of reais except for quantities in units		
	EMB 120	ERJ(a) 135/140/145	ERJ 170/190
Deferred costs	311,619	693,481	107,405
Accumulated amortization	(309,567)	(455,198)	—
Net	2,052	238,283	107,405
Quantity of aircraft projected for the program at March 31, 2001	352	960	650
Quantity of aircraft at March 31, 2001:			
Delivered	350	394	—
Firm orders	2	478	120
Options with exercisable date in (not audited):			
2001	2	103	15
2002	—	84	10
2003	—	70	10
2004	—	101	10
2005	—	55	10
Thereafter	—	20	150
Total options	2	433	205
Total	354	1,305	325

(a) The quantity of aircraft includes the Legacy backlog but does not include the EMB 145 AEW&C, EMB 145 RS and EMB 145 MP backlog.

7. Suppliers

	At December 31, 2000	At March 31, 2001
Foreign suppliers:		
Risk-sharing partners(a)	192,015	277,311
Others	300,860	651,078
Local suppliers	35,701	18,556
	528,576	946,945

(a) These risk-sharing partners develop and manufacture significant portions of the Company's aircraft, including the engines, hydraulic components, avionics, wings, interior and parts of the fuselage and tail. The Company's contracts with risk-sharing partners are long term in nature and include the following principal terms:

- Deferral of payments for components and systems for a negotiated period of time after the delivery of such components and systems.

(Expressed in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

- Minimum delivery requirement for a certain number of ERJ 145 aircraft ranging from 250 to 400 aircraft depending on the contract. In the event the Company fails to deliver this minimum number of aircraft, the Company would have to reimburse proportionally the suppliers for their tooling and development cost. Considering the number of aircraft under firm orders and deliveries already made, management believes this requirement will be met.

Once risk-sharing partners have been selected and the 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 the Company susceptible to the performance, quality and financial condition of these risk-sharing partners.

8. Loans

a. Composition

	Currency	Annual interest rate—%	At December 31, 2000	At March 31, 2001
Foreign currency:				
Materials acquisition	U.S. dollar/ Japanese Yen	1.88 to LIBOR + 0.75	356,345	258,024
Advances on export sales contracts	U.S. dollar	6.00 to 7.68	234,813	285,606
Project development	Indexed to the U.S. dollar	LIBOR + 3.00	38,519	39,767
Working capital	U.S. dollar/ French francs	7.00 to 8.00	133,697	187,199
Property and equipment acquisition	U.S. dollar	10.15 to 11.80	25,224	24,787
			788,598	795,383
Local currency:				
Project development		TJLP (long-term interest rate) + 3.00 to 5.50	115,961	108,909
Property and equipment acquisition		TJLP (long-term interest rate) + 3.30 to 4.40	2,389	3,866
			118,350	112,775
Total			906,948	908,158
Less—current maturities			726,922	734,212
Long-term portion			180,026	173,946

(Expressed in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

b. Long-Term Maturities

Year	At December 31, 2000	At March 31, 2001
2002	90,762	67,543
2003	34,558	39,738
2004	31,712	37,281
2005	21,919	28,262
2006	1,075	1,122
	180,026	173,946

c. Currency Analysis

Total debt was denominated in the following currencies:

	Exchange rate at March 31, 2001 (units of one Brazilian real)	At December 31, 2000	At March 31, 2001
Brazilian *reais*	1.0000	118,350	112,775
U.S. dollars	2.1616	669,764	643,938
French francs	0.2899	80,617	113,520
Japanese Yen	0.017122	38,217	37,925
		906,948	908,158

The exchange rates variations in relation to the Brazilian *real* were as follows:

	At March 31, 2001—%
U.S. dollars	10.55
French francs	3.25
Japanese Yen	0.23

Total debt denominated in Brazilian *reais* is subject to monetary restatement based on the variance of the Brazilian long-term interest rate—TJLP.

The annualized variation of this index was as follows:

	At December 31, 2000	At March 31, 2001
Brazilian long-term interest rate—TJLP(%)	10.75	9.25

(Expressed in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

The Company and its subsidiaries partially hedge their foreign currency liabilities. In the opinion of management, the Company's exposure to devaluation of the Brazilian real against other currencies is mitigated by the substantial amount of sales revenues which are denominated in U.S. dollars.

d. Interest and Guarantees

The foreign currency financing outstanding at March 31, 2001 was subject to weighted average annual interest of 6.84% (7.76% at December 31, 2000) plus exchange variation; for local currency financing outstanding at March 31, 2001, the weighted average annual interest rate was 12.85% (13.46% at December 31, 2000).

The Company renegotiated reductions in the spreads on loans from the BNDES (National Economic and Social Development Bank) from 4.5% for the FINEM line (a line of credit made available by BNDES to Brazilian corporations) and 6.5% for the import line to 3.0% and 5.5% per year, respectively, and on the collateral amount, effective January 1, 1997. Because of these decreases, the Company pays fees to the BNDES of 0.35% of the sales price of each ERJ 145 aircraft sold, limited to 420 aircraft sold between January 1, 1997 and December 31, 2005.

Collateral for part of these loans includes the pledge of property, machinery, equipment and inventories, in the amount of R$328,527. Of this amount, R$90,183 is related to a second mortgage on real estate.

9. Customers' Advances

	At December 31, 2000	At March 31, 2001
Local currency	31,360	24,515
Foreign currency	711,234	795,540
	742,594	820,055
Less—current portion	581,554	643,806
Long-term portion	161,040	176,249

The foreign currency advances are denominated in U.S. dollars but are presented in reais in the above chart. Segregation between current and long-term portions is based on contractual terms to deliver the related aircraft.

(Expressed in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

10. Accounts Payable

	At December 31, 2000	At March 31, 2001
Brazilian Air Force(a)	6,269	5,390
Insurance	5,013	2,507
Joint responsibilities(b)	500	—
Commercial rebates(c)	69,666	83,918
Pension fund contributions	948	888
Grant for investment from suppliers(d)	280,956	315,077
Customers credits(e)	15,399	24,626
Other	34,101	34,973
	412,852	467,379
Less—current portion	128,288	147,300
Long-term portion	284,564	320,079

(a) Amounts payable to the Brazilian Air Force represent royalties on the EMB 120 Brasília program and materials related to the delivery of AM-X aircraft.

(b) Joint responsibilities represent trade receivables discounted with recourse which customers did not pay when due and creditors have not yet exercised their rights of recourse.

(c) Commercial rebates refer to credits of spare parts given to customers.

(d) Grant for investment from suppliers represents funds and materials received from suppliers in the development of the ERJ 170/190 programs. The liabilities are waived when certain requirements are met.

(e) Refers to amounts accrued to compensate customers for certain financing costs.

11. Taxes And Social Charges Payable

a. Composition

	At December 31, 2000	At March 31, 2001
Refinanced taxes:		
INSS (social charges on payroll)	57,415	55,151
FNDE (education tax on payroll)	6,537	6,555
	63,952	61,706
Current taxes	25,548	30,412
Contingent tax and social charges(a)	115,583	130,123
	205,083	222,241
Less—current maturities	151,806	170,463
Long-term portion	53,277	51,778

(Expressed in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

(a) The Company is challenging in court the constitutionality of the nature and modifications in rates and the increase in the calculation base of certain taxes and social charges in order to obtain writs of mandamus or injunctions to avoid payments or recover past payments. As of March 31, 2001, the Company had obtained preliminary injunctions for not paying or recovering past payments of taxes and social charges in the total amount of R$130,123 monetarily restated. The monetary restatement is being charged to financial expenses.

The outstanding balances of refinanced taxes as of March 31, 2001 are subject to monthly interest of 1%, which is added to principal.

b. Maturities of long-term portion

Year	At December 31, 2000	At March 31, 2001
2002	4,599	3,427
2003	4,599	4,569
2004	4,599	4,569
2005	4,599	4,569
2006	4,599	4,569
2007	4,599	4,569
2008 to 2013	25,683	25,506
	53,277	51,778

12. Accrued Liabilities

	At December 31, 2000	At March 31, 2001
Contingencies(a)	29,731	29,559
Accrued vacations	59,548	60,586
Accrued pension benefit cost	5,245	6,740
Employee profit sharing	52,681	25,406
Product warranties	91,642	103,958
Product improvement(b)	84,980	96,354
Deferred State VAT and taxes on sales	5,346	5,721
Provisions for losses on contracts	23,186	23,176
Accrued Trade Concession(c)	27,112	29,392
Other	12,899	23,683
	392,370	404,575
Less—current portion	363,889	375,961
Long-term portion	28,481	28,614

(a) The Company is subject to lawsuits in the ordinary course of business. The accrual for contingencies is recorded based on the opinion of legal counsel, with regard to the expected outcome of all pending lawsuits. The accrued amounts are based on expected success in certain current lawsuits and settlement negotiations in progress.

(Expressed in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

The composition of accrual for contingencies as of March 31, 2001 is as follows:

	R$ million
Labor contingencies related to:(1)	
Retroactive wage increase (i)	1.5
Individual labor claims with regard to overtime and other matters (ii)	7.5
1992 salary adjustments (iii)	6.3
CBA-123 program(2)	0.3
Import tax(3)	1.3
FUNDAF(4)	9.0
Tax contingencies(5)	3.7
	29.6

(1) The labor lawsuits are brought by unions on behalf of employees or by individuals, as described below:

(i) This lawsuit was filed in June 1991 on behalf of all employees employed at the Company as of November 1990. The lawsuit seeks to apply retroactively to November and December 1990 a wage increase implemented by the Company in January and February 1991 pursuant to an agreement between the Company and a labor union. The total exposure for payment of the retroactive salaries, including interest accrued thereon, amounted to R$5.8 million as of March 31, 2001. The Company lost this suit in 1996 and from that time the regional labor court in Brazil began analyzing the amount to be paid to the employees. In July 1997, the Company settled with 95% of its current employees, paying an aggregate of R$18.9 million. The Company settled with 3,176 out of 4,244 former employees, paying an amount of R$8.2 million and R$12.3 million during 1999 and 2000, respectively. The Company is currently attempting to settle this case with the employees who have not yet settled.

(ii) The Company is a defendant in approximately 409 lawsuits related to individual labor claims with respect to overtime, readmission and additional amounts, in many of which the Company expects to receive favorable judgments. The total exposure for payment in connection with these individual claims amounts to R$9.2 million. The Company settled with several employees and paid others based on adjudicated amounts in the total amount of R$4.4 million and R$10.3 million during 1999 and 2000, respectively.

(iii) This lawsuit was filed by 1,219 employees and by the union on behalf of certain employees employed in 1992 with respect to salary adjustments for that year. The Company lost this suit and was ordered to adjust salaries, in accordance with a productivity index, and to refrain from dismissing certain striking workers for a period of 90 days. As of December 31, 1998, the Company had reached a settlement with approximately 90% of its employees included in the lawsuit filed by the labor union pursuant to which the Company paid approximately 30% of the amount determined in the judgment. During 1999 and 2000, the Company entered into an agreement with the labor union to end the case and paid the amounts of R$2.7 million and R$1.2 million respectively, for the remaining 10% of its employees. The total exposure for payment to current and former employees who filed suit individually amounts to R$8.7 million. The Company is currently attempting to settle this case with the employees individually.

(2) This provision refers to taxes and contractual contingencies related to the CBA-123 program, which was discontinued after the construction of three prototypes. During 1999, the Company entered into an agreement with suppliers to settle the contractual contingencies in the amount of R$1.0 million.

(3) This provision relates to import duty and VAT tax (IPI) owed on imported materials for two flight simulators, which must be exported within a certain time period to be exempt from such taxes. The materials were exported after the previously established period. The Company is currently discussing the payment terms of the assessment with the tax authorities.

(4) This provision relates to a contribution called FUNDAF (Special Fund for Development and Improvement of Fiscalization), owed to the Internal Revenue Department on customs clearance of imported materials. In October 1999, tax authorities assessed the Company, which is currently challenging the legality of such contribution.

(5) This provision refers to a deficiency notice from the Internal Revenue Department for social contributions which are being challenged.

Additionally, the Workers Union initiated a lawsuit against the Company in October 1992 on behalf of 7,283 current and former employees, which is currently awaiting a ruling by the Superior Labor Court, Brazil's highest appellate court for labor disputes. The plaintiffs are seeking payment of salary differences based on existing agreements between the labor unions and the Federação das Indústrias do Estado de São Paulo, or the Industry Federation of the State of São Paulo, also known as FIESP. The total exposure for payment of retroactive salaries was R$62.0 million on March 31, 2001. At March 31, 2001, the Company had not accrued any amounts for this lawsuit. Management believes, based on advice of Brazilian counsel, that this lawsuit will not result in a decision adverse to the Company. Final judgment is not expected to occur before the second half of 2001.

In addition, the Company is involved in other legal proceedings, all of which are in the ordinary course of business. In the opinion of management, none of these proceedings is expected to have a material adverse effect on the financial condition or results of operations of the Company.

(b) This refers to amounts accrued to implement improvements in aircraft sold to maintain achievement of contractual performance indices.

(c) Accrued trade concession represents expenses in connection with the obligation to provide technical assistance and training of mechanic and airplane crew of customers.

13. Dividends

In conformity with the Company's bylaws, shareholders are entitled to minimum dividends equivalent to 25% of annual net income computed in accordance with the accounting principles emanating from Brazilian corporate law. The Company's preferred shares do not have voting rights but have priority in capital redemption and, in accordance with present corporate law, have the right to dividends in an amount 10% greater than those payable to the common shares.

Dividends are calculated on the Company's adjusted net income for the year, which is determined using the equity method of accounting for subsidiaries. Additionally, from 1996 on, due to the cessation of the price-level restatement adjustments in the corporate law method financial statements, the effect of those adjustments on consolidated net income in the accompanying financial statements must be eliminated to arrive at distributable income on a corporate law basis.

The Company has elected to pay interest on shareholders' capital, calculated on a quarterly basis in accordance with article 9 of Law No. 9,249/95 based on the TJLP, for deductibility purposes in computing income and social contribution taxes, and charged directly to shareholders' equity for reporting purposes, in compliance with CVM Instruction No. 207/96.

On March 16, 2001, the Board of Directors, subject to ratification at the next Annual Shareholders' Meeting that will consider the financial statements for 2001, approved the payment of interest on capital (starting April 23, 2001) equivalent to minimum dividends for the first quarter of the current year in the amount of R$28,937, net of withholding income tax. The interest on capital paid to holders of preferred shares, net of withholding income tax, was R$0.0555133 per share and R$0.050466 per share, on the common shares. Interest on capital is shown net of withholding income tax at the official rate of 15%. Shareholders that are exempt from the withholding income tax will receive the gross amount of interest on capital.

14. Debentures

The Extraordinary Shareholders' Meeting, on December 11, 1998, approved the issuance of the fourth series of debentures, coupled with 100 detachable subscription warrants per debenture.

Each subscription warrant entitles its holders to purchase 10 preferred shares, or, in certain circumstances, 10 common shares at any time after June 6, 2000 or 90 days after any public offering of shares, whichever occurs first. If and when the subscription warrants are exercised, the issue price will be R$1.83 per share, as adjusted by the Brazilian long-term interest rate (TJLP) from July 1, 1998. The issue price was higher than the market price of the shares at the date of issuance of the debentures.

The additional issuance, which was subscribed and paid for in February and March 1999, consists of 83,330 debentures, with a face value of R$1,800.00 each, in the historical total amount of R$150.0 million, to be repaid in five installments as follows: 10% on July 1, 2001, 10% on July 1, 2002, 60% on July 1, 2003, 10% on July 1, 2004 and 10% on July 1, 2005.

The face value is restated based on the Brazilian long-term interest rate (TJLP) from the issue date to the maturity date plus 2% per year and an additional interest of 5% per year, calculated on a daily "pro rata" basis on the restated face value. The Company will not pay the premium if any of the circumstances described below occur:

- The subscription warrants are traded by the debenture holders separately from the debentures.
- The subscription warrants are exercised.
- Market conditions allow the negotiation of shares equal to or greater than a preestablished price.

(Expressed in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

On February 18, 2000, 833,500 subscription warrants were exercised for the issuance of 8,335,000 preferred shares, paid with 8,335 debentures which are held in treasury.

The issue price of the shares was R$2.4228 per share, totaling R$20,194. Of this amount, 30% was allocated to capital reserves and the balance to capital, as stipulated in item 4.2.11 of clause 4 of the deed of the 4th issue of debentures.

On July 27, 2000, BNDES Participações S.A.—BNDESPAR, which is the sole holder of the debentures, exercised 105,700 subscription warrants, with the issuance of 1,057,000 preferred shares. The issue price of the shares was R$2.4928 per share, totaling R$2,635, 30% of which was allocated to capital reserves and the balance to capital, as required under the debenture indenture agreement.

At March 31, 2001, the monetarily restated value of these outstanding debentures was R$181,655 and accrued interest was R$2,748. The premium was not accrued at March 31, 2001 since the share negotiation price (R$21.50) was above the preestablished price (R$3.5605).

15. Shareholders' Equity

a. Capital

At March 31, 2001 the Company's statutory fully paid-in capital stock is represented as follows:

Classes of shares	Quantity
Registered common shares	242,544,447
Special registered common share	1
Preferred shares	300,865,426
	543,409,874

a.1. Special Registered Common Share—"Golden Share"

A special registered common share (''golden share'') is held by the Brazilian Government. As the holder of the golden share, the Brazilian Government is entitled to the same voting rights as the other holders of common shares. In addition, the golden share carries veto power over the following corporate actions relating to the Company:

- Change of corporate purpose.
- Change of name.
- Alteration and use of logo.
- Creation or alteration of defense programs (whether the Brazilian government participates or not in such programs).

(Expressed in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

- Acceptance, for defense programs, of the technological qualifications of third parties.
- Interruptions in the supply of maintenance and spare parts for defense aircraft.
- Change of control.
- 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 attributed to the golden share.

a.2. Composition of Shareholders

Shareholders	Common	Preferred	Total
Caixa de Previdência dos Funcionários do Banco do Brasil—PREVI	59,243,379	59,356,935	118,600,314
Fundação SISTEL de Seguridade Social	48,508,890	14,639,674	63,148,564
Cia. Bozano	48,509,220	14,260,613	62,769,833
Bozano Holdings, Ltd.	—	44,429,611	44,429,611
Kol Fund. Inv. em Ações(a)	125,877	17,845,796	17,971,673
Icatu Fes Portfolio Fdo Mutuo de Inv.	781,355	5,173,335	5,954,690
Fdo M I A CL BSA	—	2,569,468	2,569,468
Dassault Aviation	13,744,186	—	13,744,186
Thomson CSF	13,744,186	—	13,744,186
EADS	13,744,186	—	13,744,186
SNECMA	7,276,332	—	7,276,332
BB—Banco de Investimentos S/A	3,015,562	2,156,000	5,171,562
Federal Government	3,514,388	—	3,514,388
Other	30,336,887	140,433,994	170,770,881
	242,544,448	300,865,426	543,409,874

(a) This investment fund is controlled by Fundação SISTEL de Seguridade Social.

b. Reverse Split

At the Shareholders' Meeting held on April 30, 1999, a reverse stock split was approved at the ratio of 100 to 1; as a result, shareholders now hold one new common or preferred share for each hundred shares of the same type previously held. After the reverse split, the Company's shares are negotiated on the stock exchanges at unit prices.

The fractional shares from the exchange of common and preferred shares were sold on the São Paulo Stock Exchange on September 28 and 29, 1999, and the credits are available at the Company, in the name of the shareholders.

(Expressed in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

c. *Stock Options*

The special shareholders' meeting, held on April 17, 1998, approved a stock option plan for management and employees of the Company and its subsidiaries, subject to restrictions based on continuous employment with the Company or its subsidiaries for at least two years. The plan Administration Committee, which was appointed at the Board of Directors meeting held on April 17, 1998, is responsible for defining the rules and managing the plan.

Under the terms of the plan, options for 25,000,000 preferred shares are authorized to be granted. At the end of the third and fourth years, subsequent to the grant, the employees will have the right to exercise 30% of the options so granted, respectively, and the remaining 40% is exercisable at the end of the fifth year, if still employed by the Company on each date. As of March 31, 2001, the Administration Committee had made six grants, equivalent to 358 lots of 50,000 shares each, totaling 17,900,000 preferred shares, net of 50,000 shares of which were forfeited, as the beneficiaries are no longer employees of the Company. Of this total, 25.2%, equivalent to 4,515,000 preferred shares, may be exercised starting May 31, 2001, and 3.4%, equivalent to 600,000 preferred shares, starting November 30, 2001.

Options are granted with an exercise price equal to the weighted average price of the Company's preferred shares traded on the São Paulo Stock Exchange in the 60 trading days prior to the granting date, increased or decreased up to 30%, as defined by the Plan Administration Committee. Such percentage is deemed to offset unusual fluctuations in the market price during this 60-day period.

The plan terminates five years after the first grant. No amounts have been charged to expense for the options.

Information regarding options granted to management and employees is shown in the following table:

	Shares
Available for grant as of April 17, 1998	25,000,000
Granted:	
1998	7,250,000
1999	5,400,000
2000	5,250,000
	17,900,000
Available for grant as of March 31, 2001	7,100,000

(Expressed in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

Status of Options as of March 31, 2001

Grant date	Exercise date	Maturity	Number of shares granted
May 1998	May 2001	May 2005	4,515,000
November 1998	November 2001	November 2005	600,000
May 1998 and 1999	May 2002	May 2005 and 2006	1,245,000
November 1998 and 1999	November 2002	November 2005 and 2006	1,640,000
May 1998, 1999 and 2000	May 2003	May 2005, 2006 and 2007	2,535,000
November 1998, 1999 and 2000	November 2003	November 2005, 2006 and 2007	1,730,000
May 1999 and 2000	May 2004	May 2006 and 2007	2,425,000
November 1999 and 2000	November 2004	November 2006 and 2007	1,110,000
May 2000	May 2005	May 2007	1,580,000
November 2000	November 2005	November 2007	520,000
Total options granted			17,900,000

16. Financial Instruments

Estimated fair values of the Company's financial assets and liabilities have been determined using available market information and appropriate valuation methodologies. However, considerable judgment was required in interpreting market data to produce the estimated fair values. Accordingly, the estimates presented below are not necessarily indicative of the amounts that could be realized in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair values.

As of March 31, 2001, the Company had the following principal financial instruments:

(a) Cash, Cash Equivalents, Trade Accounts Receivable, Other Current Assets, Accounts Payable and Accrued Expenses—The carrying value of cash, cash equivalents, trade accounts receivable, other current assets, accounts payable and accrued expenses approximate their fair value.

(b) Investments—Consist mainly of subsidiaries and affiliates accounted for under the equity method or at restated cost and which have strategic interest for the Company's operations; market value considerations are not applicable.

(c) Loans—Subject to interest at usual market rates, as described in Note 8. The estimated fair value was calculated based on present value of future cash outflow using interest rates that are currently available to the Company for issuance of debt with similar terms and maturities. The estimated fair value for the loans, including short term installments, is as follow:

	At March 31, 2001
Book value	908,158
Fair value	874,797

(Expressed in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

(d) *Financed Taxes*—The conditions are similar to the usual terms for financed taxes and there are no material differences related to interest rates applicable to loans. The estimate fair value was calculated based on present value of future cash outflow using interest rates that are currently available to the Company for issuance of debt with similar terms and maturities. The estimated fair value for the financed taxes, including short term installments, is as follows:

	At March 31, 2001
Book value	61,706
Fair value	39,516

(e) *Derivatives*—The derivative financial instruments held by the Company at March 31, 2001 consist of foreign currency forward contracts and swaps. The Company does not trade in derivatives for speculation purposes.

Foreign currency option contracts were entered into to reduce the Company's exposure to risk related to a sale contract comprising one firm order for ERJ 135/145 regional jets, which includes an option for the purchaser to pay in Euros. As of March 31, 2001, the estimated value of the foreign currency option contract expiring in April 2001 and denominated in U.S. dollars was US$13.1 million. These foreign currency option contracts are recorded at their spot market value at the balance sheet date and unrealized losses are recognized in the income statement. Unrealized gains in the amount of R$1,248 as of March 31, 2001 were deferred to be recognized at the exercise dates which are approximately the same as those for the deliveries of the related aircraft.

The foreign currency forward contracts, which are associated with accounts receivable of a specific customer, denominated in U.S. dollars, are intended to partially cover the foreign exchange market risk based on the Brazilian real/U.S. dollar exchange rate, for a period of 90 days with maturity on May 22, 2001. As of March 31, 2001, the notional amount is US$20.0 million with a fixed U.S. dollar exchange rate. The foreign currency forward contracts are recorded at their spot market value at the balance sheet date and unrealized losses of R$2,132 were recognized in the statement of income.

Foreign currency forward contracts were also entered into to cover the future maturity of specific risk of import financing obtained in Japanese yen, converting the debt into U.S. dollars; as of March 31, 2001, the notional amount of these contracts was US$22.1 million. The foreign currency forward contracts are recorded at their spot market value at the balance sheet date and unrealized losses of R$4,456 were recognized in the statement of income.

The foreign exchange rate swaps, which are associated with accounts receivable of a specific customer, denominated in U.S. dollars, are intended to partially cover the foreign exchange market risk based on the Brazilian real/U.S. dollar exchange rate, for the period of 83 days with maturity on April 26, 2001. As of March 31, 2001, the notional amount is US$26.2 million. The foreign exchange rate swaps are recorded at their spot market value at the balance sheet date and unrealized losses of R$2,816 were recognized in the statement of income.

17. Supplementary Retirement Plan

a. Company

On June 26, 1998, the Board of Directors approved the implementation of the Embraer Supplementary Retirement Plan, with the Company initiating its contributions on July 1, 1998.

The plan is a private, defined-contribution plan where participation is optional; it is administered by a Brazilian pension fund administrator controlled by Banco do Brasil. Company's contributions to the plan for the three months ended March 31, 2000 and 2001 were R$1.699 and R$2.120, respectively.

b. Subsidiaries

The Embraer Aircraft Corporation 401(k) Retirement Plan (the ''401(k) Plan'') was originally established by EAC as a profit sharing plan on January 1, 1981. On November 1, 1993, the 401(k) Plan was amended and restated to comply with the provisions of section 401(k) of the U.S. Internal Revenue Code as a defined contribution, deferred compensation plan. Employees who have attained age 21 and provided 1,000 hours of service during a year are eligible for participation. EAC's profit-sharing contributions to the 401(k) Plan are discretionary. EAC may also match a discretionary percentage of the amount contributed by the participant up to a specified dollar amount. Vesting in company matching contributions is 20% after three years of service, 40% after four years, 60% after five years, 80% after six years and 100% after seven years. EAC did not make a profit sharing contribution or a matching contribution for the years ended December 31, 1998, 1999 and 2000.

EAC also sponsors a defined benefit plan, which includes a pension plan and a post-retirement medical plan. The plans cover substantially all employees, with retirement benefits based on compensation levels and the number of years of covered service. EAC makes contributions to the plans as required to meet Internal Revenue Service funding standards. To determine the periodic pension expense and contribution to the plan the actuarial method used is the ''projected unit credit method''.

The expected costs of providing post-retirement medical benefits to an employee and the employee's beneficiaries and covered dependents are accrued during the years that the employee renders the necessary service.

The net periodic benefit cost is included in selling, general and administrative expenses in the accompanying statements of operations.

The subsidiaries Indústria Aeronáutica Neiva S.A.-NEIVA, ELEB-Embraer Liebherr Equipamentos do Brasil S.A. and Embraer Aviation International-EAI have private supplementary retirement plans for their employees; the plans are the defined contribution type, and participation by the employees is optional. Subsidiaries contributions to the plan for the three months ended March 31, 2000 and 2001 were R$263 and R$617, respectively. (NEIVA R$27, ELEB R$58 and EAI R$178 in 2000 and NEIVA R$48, ELEB R$79 and EAI R$490 in 2001).

(Expressed in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

18. Employee Profit Sharing

The Company has an employee profit sharing policy linked to action plans and specific goals which are established and agreed upon at the beginning of each year. On March 31, 2001, the Company recognized an expense for employee profit sharing in the amount of R$10,485 (R$6,469 in 2000).

19. Monetary and Exchange Variations, Net

	Three months ended March 31,	
	2000	2001
Exchange variations:		
Assets	(32,702)	116,393
Liabilities	39,164	(279,419)
Allocated gain on monetary items	30,931	25,405
Exchange variations, net	37,393	(137,621)
Monetary variations:		
Assets	812	1
Liabilities	(11,072)	(13,380)
Allocated gain on monetary items	10,295	7,615
Monetary variations, net	35	(5,764)
Monetary and exchange variations, net	37,428	(143,385)

20. Other Operating Expense, Net

	Three months ended March 31,	
	2000	2001
Insurance Recovery	286	1,987
Improvements on production process	(2,445)	(3,669)
Feasibility study costs on new products development	(21,129)	(8,222)
Provision for realization of recoverable value-added tax	—	(5,295)
Provision for losses on other accounts receivables	(2,344)	—
Others	812	(3,258)
	(24,820)	(18,457)
Unallocated inflationary effects	2,018	5,477
	(22,802)	(12,980)

(Expressed in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

21. Nonoperating Income (Expense), Net

	Three months ended March 31,	
	2000	2001
Sales of property items	39	78
Provision for losses on investments—fiscal incentives	—	(5,053)
Others	265	(125)
	304	(5,100)

22. Responsibilities and Commitments

The Company may have to repurchase a number of aircraft. The price per aircraft on any such required repurchase is less than the original sale price of the aircraft and less than management's current estimate of the market value of the relevant aircraft type in the future years (based on current third-party appraisals of the same type of aircraft). If the Company is required to repurchase all of the relevant aircraft under the Company's repurchase obligation, which covers the period from 2003 to 2007, the Company may be required to pay up to approximately US$500 million for these aircraft. Based on the Company's current estimates and third-party appraisals, management believes that any repurchased aircraft could be sold in the market without loss.

The Company is also subject to trade-in options for approximately 5% of the firm orders, including aircraft which have already been delivered. These options provide that the repurchase price can be applied to the price of an upgraded model or any of the Company's other aircraft. The repurchase price is determined in the manner discussed above for regional jets and as a percentage of the original purchase price for corporate jets. The Company may be required to accept trade-in options at repurchase prices that are above the then market price of aircraft. The Company is not able to determine the extent of its financial exposure under these trade-in options, which may result in substantial losses in the event that the repurchase prices are above the then market price of aircraft.

The Company has also guaranteed directly or indirectly the minimum residual value of some of its aircraft, including aircraft that have already been delivered. These guarantees run in favor of certain customers or providers of financing to customers. In accordance with the Company policy and based on third-party appraisals, this minimum residual value does not exceed the appraisal value of each aircraft delivered. The value of the guarantee typically ranges from 18% to 25% of the sales price in the 15th year after the year of delivery. The Company is not able to determine the terms nor the extent of its financial exposure under these guarantees, which may result in substantial payments in the event that actual residual values of the related aircraft decline below the guaranteed levels.

The subsidiary Embraer Aircraft Corporation-EAC is obligated under noncancellable operating leases for land and equipment. Such leases expire at various dates through 2020.

(Expressed in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

Future minimum lease payments are as follows:

Year	R$
2001	922
2002	1,195
2003	935
2004	636
2005	636
Thereafter	6,571
	10,895

The installations of Embraer Aircraft Corporation-EAC are located on land leased under a lease extending through the year 2020; the lease includes a clause which obligates EAC to make investments, totaling R$19,777. Management believes that this obligation has been satisfied, based upon construction projects performed by sublessees.

23. Income and Social Contribution Tax Credits

a. Tax Credits

As of March 31, 2001, the Company and its subsidiaries had tax loss carryforwards for income and social contribution taxes, for which there are no expiration dates for utilization, composed as follows:

	At March 31, 2001	
Year	Income tax	Social contribution
1992	114,226	1,329
1993	21,270	14,086
1994	8,136	2,150
1995	162,617	3,450
1996	216,755	30,422
1997	70,176	27,869
1998	13	13
1999	81	81
2000	19	19
	593,293	79,419

The Company adopted the criteria of recognizing deferred tax assets on tax loss carryforwards when realization, based on internal studies and projections, is probable.

These studies indicate that the present amounts should be realized within three years.

(Expressed in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

The components of deferred tax assets and liabilities, at December 31, 2000 and March 31, 2001, are as follows:

	At December 31, 2000	At March 31, 2001
Deferred income tax asset on:		
Income tax losses	178,493	148,323
Social contribution tax losses	17,356	7,148
Tax loss carryforwards, net	195,849	155,471
Temporary differences-		
Reserve for contingencies	5,599	5,489
Provision for realization of investments	1,674	1,948
Provision for losses on deferred charges	555	547
Provision for product warranties	26,482	30,351
Provision for product improvement	28,894	32,761
Accrued taxes other than income taxes	48,088	53,517
Reserve for inventories	50,044	56,940
Provision for realization of prepaid value-added tax	8,396	3,265
Pension accrual	1,771	1,930
Provision for losses on contracts	4,465	5,059
Allowance for doubtful account	1,432	1,724
Trade Concession	9,218	9,993
Accrued bonuses	3,287	8,314
Unrealized losses on derivatives instruments	1,556	4,731
Accrual taxes on unbilled revenues	1,768	1,945
Other	13,024	26,059
	206,253	244,573
Total asset	402,102	400,044
Deferred income tax liability on:		
Temporary differences-		
Fixed asset revaluation	(20,794)	(13,618)
Special monetary restatement-IPC index	(10,091)	(16,355)
Equity pick-up from subsidiary located in tax haven	(13,265)	(13,079)
Exchange variation	(1,360)	(1,262)
Difference in revenue recognition	(1,926)	(902)
Accelerated depreciation	(1,623)	(1,770)
Other	(2,641)	(131)
Effect of monetary restatement adjustments	(99,509)	(93,833)
Total liability	(151,209)	(140,950)
Net deferred tax asset	250,893	259,094

(Expressed in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

The deferred tax on full indexation (''Effect of monetary restatement'') relates to the difference between the tax basis of nonmonetary assets, which was not indexed for inflation subsequent to December 31, 1995, and the reporting basis, which includes indexation through March 31, 2001.

The net deferred tax asset was reflected in the consolidated balance sheets as follows:

	At December 31, 2000	At March 31, 2001
Deferred income tax assets:		
Current	230,725	229,204
Noncurrent	171,377	170,840
	402,102	400,044
Deferred income tax liabilities:		
Current	(1,360)	(1,262)
Noncurrent	(149,849)	(139,688)
	(151,209)	(140,950)
	250,893	259,094

(Expressed in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

24. Statement of Cash Flow

	Three months ended March 31, 2000	Three months ended March 31, 2001
Operating activities:		
Net income for the period	94,134	191,895
Adjustments to reconcile net income to net cash provided by operating activities-		
Depreciation and amortization	51,128	60,057
Allowance for doubtful accounts	2,349	3,934
(Gain) Loss on permanent asset disposals	916	(16)
Interest of loans, tax installments and debentures	25,944	15,459
Monetary and exchange variations on loans, tax installments and debentures	(186,013)	45,970
Translation adjustment on consolidated foreign investments	4,650	(15,411)
Provision for (reversal of) losses	(170)	10,515
Reversal of deferred income	(20)	(3)
Deferred income taxes and social contribution tax	6,594	(15,603)
Equity in unconsolidated subsidiary	(135)	—
Reserve for contingencies	13	405
Minority Interest	—	107
	(610)	297,309
Changes in current assets and liabilities-		
Accounts receivable	11,380	(163,445)
Inventories	89,257	(279,206)
Prepaid expenses	(1,152)	(1,790)
Recoverable taxes	646	(7,076)
Other receivables	7,442	(10,010)
Suppliers	81,899	418,369
Accrued taxes on income	27,368	(4,261)
Accrued liabilities	(5,441)	12,072
Customers advances	45,779	62,252
Taxes and social charges payable	21,767	19,745
Other	12,899	19,920
	291,844	66,570

(Expressed in thousands of constant Brazilian reais as of March 31, 2001, unless otherwise indicated)

	Three months ended March 31,	
	2000	2001
Changes in noncurrent assets and liabilities-		
Accounts receivable	(105,960)	(6,158)
Recoverable taxes	3,815	4,059
Other receivables	2,383	5,633
Accounts payable	22,668	27,218
Customers advances	7,037	15,209
Accrued liabilities	(479)	(272)
Taxes payable	(739)	(1,122)
	(71,275)	44,567
Net cash provided by operating activities	219,959	408,446
Investing activities:		
Sales of property, plant and equipment	39	78
Compulsory loans	18	(2,119)
Additions to property, plant and equipment	(23,914)	(43,428)
Additions to deferred charges	(8,086)	(47,189)
Net cash used in investing activities	(31,943)	(92,658)
Financing activities:		
Loans repaid	(354,632)	(887,543)
New loans obtained	373,532	821,175
Payment of refinanced taxes	(1,448)	(1,127)
Guarantee deposits	(3,326)	(6,689)
Grant for investments from risk sharing suppliers	—	8,290
Interest on capital	(21,557)	(36,328)
Dividends paid	(67,586)	(44,252)
Payment of interest on debentures	(260)	—
Net cash used in financing activities	(75,277)	(146,474)
Net increase in cash and equivalents	112,739	169,314
Cash and equivalents, beginning of the period	611,255	2,358,602
Cash and equivalents, end of the period	723,994	2,527,916
Supplemental cash flow disclosure:		
Cash paid during the year for-		
Income taxes	28,383	98,836
Interest	28,252	22,883
	56,635	121,719

25. World Trade Organization-WTO

In April 1999 the World Trade Organization, or 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. The WTO ruled that Brazil must withdraw the prohibited portions of its export subsidies for regional aircraft under the ProEx program and recommended that it conform the ProEx program to the WTO rules by November 18, 1999. On November 19, 1999, the Brazilian and Canadian governments presented to the dispute resolution body of the WTO the modifications that they made to bring their respective programs into compliance with the WTO rulings. Both countries then declared that the other's modifications were unsatisfactory and did not comply with the WTO rulings.

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 the customers of the Company prior to November 18, 1999 were prohibited export subsidies. The WTO also concluded that the amended version of the ProEx program still decreased effective interest rates for regional aircraft to below commercial market levels and thus continued to provide a prohibited export subsidy. The Brazilian government publicly announced that it intends to honor its contractual commitments to the Company's customers. However, the Company cannot provide assurances that the Brazilian government will, in fact, honor its contractual commitments to the customers, or that, if it does, its trade relations with Canada or other countries will not suffer. The Brazilian government also announced that it would further amend the ProEx program to provide that any ProEx payments would not decrease the effective interest rate below the commercial interest reference rate permitted by the WTO regulations without proof that the actual market interest rate is lower than the commercial interest reference rate. Canada is challenging the Brazilian government's interpretation of the scope of application of the WTO's effective interest rate restrictions.

A substantial percentage of the Company's customers benefit from the ProEx program. A reduction of existing commitments under the ProEx program could cause the Company to reduce prices or otherwise compensate the customers or could result in the cancellation of firm orders in backlog, which could reduce the sales and profitability of the Company. If the ProEx program or another similar program is not available in the future, or if its terms are substantially reduced, the customers' financing costs could be higher and the cost-competitiveness of the Company in the regional jet market could decrease.

As a result of Brazil's decision to maintain its contractual commitments under the ProEx program, the WTO dispute settlement body granted Canada 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. The Company cannot predict what form, if any, these sanctions will take and whether any such sanctions will adversely affect its business. In addition, the Canadian government has 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. Brazil is challenging this financing before the WTO. If the WTO determines that these or any other government-sponsored financing that benefits the Company's competitors is permissible, the cost-competitiveness of the Company's aircraft in the regional jet market would suffer, which could cause the Company's customers to reduce their orders or fail to exercise their options.

26. Subsequent Event

On May 3, 2001, 7,393,800 subscription warrants were exercised by BNDES Participações S.A.-BNDESPAR (the sole holder of the debentures), with the issuance of 73,938,000 preferred shares at a per share price of R$2.47685, totaling R$183,133. These shares were paid with 73,938 debentures.

As stipulated in item 4.2.11 of the debenture indenture agreement for the 4th issue, 30% of the subscribed amount for the preferred shares issued, totaling R$54,940, was allocated to capital reserves and the balance totaling R$128,193 was allocated to capital.

The aforementioned shares will have the same features, conditions, statutory rights and advantages currently attributed to preferred shares, as well as to any dividends, distributions or any rights determined in corporate actions starting May 3, 2001.

After the exercise of the subscription warrants, the Company's statutory capital increased from R$808,984 to R$937,177, divided into 617,347,874 shares, without par value, consisting of 242,544,448 common shares, including one special golden share, and 374,803,426 preferred shares. The capital increase will be approved at the next Board of Directors' meeting.

27. Differences Between U.S. and Brazilian Generally Accepted Accounting Principles

The significant differences between U.S. and Brazilian generally accepted accounting principles are described in Note 30 to the Company's annual audited financial statements at and for the years ended December 31, 1998, 1999 and 2000. Except for the adoption of SFAS No. 133 ''Accounting for Derivative Instruments and Hedging Activities'', discussed below, the reconciling items as of and for the three months ended March 31, 2000 and 2001 would be of a recurring nature and similar to those reconciling items disclosed in that note. In the opinion of the Company's management, no new events or changes in accounting policies have occurred which would give rise to any new reconciling items.

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 133. SFAS No. 133 is effective for transactions entered into after January 1, 2000. SFAS No. 133 requires that all derivative instruments be recorded on the balance sheet at fair value. Changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income, depending on whether a derivative is designated as part of hedge transaction and type of hedge transaction. The ineffective portion of all hedges will be recognized in earnings. The Company has initially assessed that its current derivative instruments do not qualify for being designated as hedges mainly because the Company has no written documentation as how to measure the ineffectiveness of such instruments as well as because certain of the derivatives carried by the Company do not match their intended hedged items in terms of notional amount and settlement date. Under SFAS No. 133 the Company would record a loss of R$2,174 related to the unrealized losses on foreign currency options and swaps, considered to be free standing derivatives.

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[artwork to be inserted]

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