

Q2 2020 Earnings Call

Company Participants

- Antonio Carlos Garcia, Executive Vice President, Finance and Investor Relations
- Eduardo Couto, Director of Investor Relations
- Francisco Gomes Neto, President and Chief Executive Officer

Other Participants

- Cai Von Rumohr, Analyst
- Gabriel Rezende, Analyst
- Myles Walton, Analyst
- Noah Poponak, Analyst
- Robert Spingarn, Analyst
- Ronald Epstein, Analyst

Presentation

Operator

Good morning, ladies and gentlemen, and welcome to the audio conference call that will review Embraer's Second Quarter of 2020 Results. Thank you for standing by. At this time, all participants are in listen-only mode. Later, we will conduct a question-and-answer session. (Operator Instructions) As a reminder, this conference is being recorded and webcasted at ri.embraer.com.br.

This conference call includes forward-looking statements or statements about events or circumstances, which have not occurred. Embraer has based these forward-looking statements largely on its current expectations and projections about future events and financial trends affecting the business and its future financial performance.

These forward-looking statements are subject to risks, uncertainties and assumptions, including among other things, general economic, political and business conditions in Brazil and in other markets where the company is present.

The words believes, may, will estimates, continues, anticipates, intends, expects and similar words are intended to identify forward-looking statements. Embraer undertakes no obligations 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 on this conference call might not occur. The company's actual results could

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differ substantially from those anticipated in the forward-looking statements.

Participants on today's conference call are Mr. Francisco Gomes Neto, President and CEO; Mr. Antonio Carlos Garcia, Executive Vice President, Finance and Investor Relations; and Mr. Eduardo Couto, Director of Investor Relations.

I would like now to turn the conference over to Mr. Francisco Gomes Neto. Please go ahead.

Francisco Gomes Neto {BIO 19328044 <GO>}

Good morning, everyone, and thank you all for joining our call today. I am Francisco Gomes Neto, President and CEO of Embraer. I'll make some initial remarks before turning to our CFO, Antonio Garcia who will detail the results of the company.

Our main priority continues to be the health and safety of our people focusing on preventive measures raising awareness on the risks and right behaviors to avoid the contamination and reduce the spread of COVID-19. Regarding business continuity there are key initiatives in place to emphasize business intelligence in alignment within the management team to implement the necessary measures to support the company's short and medium-term performance.

In the short-term, our focus continues to be on cash preservation. Besides initiatives already implemented such as a more strict control of accounts payable, accounts receivable, general expenses and investments, we had advantage in additional initiatives such as the implementation of world-class procurement and logistics areas to bring more focus and intelligence on our purchasing and material management processes.

The focus here is to reduce further in a very structured way the cost of what we buy and reduce our inventory levels as well. More specifically in the field of expenses control, we have implemented a new process called spending control tower with a new and much more robust approval process for indirect purchases.

In operations, we have initiated many projects to reduce the production cycle of our aircrafts through where we structured value stream mapping processes combined with a series of Kaizen projects. These initiatives will contribute a lot to reduce costs of our products as well as working capital. As I said, all these initiatives will help us to improve our financial performance in the short and medium-term. Through the COVID-19 pandemic in the current market scenario, Embraer keeps pursuing measures to become a leaner and more efficiency organization.

We have started the restructuring process initially with important changes in the top management. We consolidated the Vice Presidencies of Engineering and Strategy and adjusted the structure in operations Commercial Aviation and EmbraerX. Here I'd like to thank the VPs Mauro Kern, Nelson Salgado and Helio Bambini who left our organization in this process for a greater contribution to the company over the past years.

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We also revised our second layer of directors and managers eliminating duplications created during the separation of the commercial aviation business. In short, we have already recovered the synergies over the last few months. Such changes in the organization has a focus not only on cost reduction, but also to help us to better executing our strategic plan '21, '25 keeping our strength in all key areas such as market intelligence, sales, engineering, technology, operations, finance, procurement and innovation.

It is important to highlight that all the initiatives and projects we are created and implemented in a very collaborative process involving the leadership team and key persons of different levels of the organization helping us to achieve high levels of engagement, commitment and motivation even during this very tough moment. Regarding the business plan update, we are working to finalize our strategic plan for the period of '21 to '25, which we expect to conclude in the coming weeks.

We are focusing on improving our cost structure with short-term actions, but at the same time making sure we will have the intelligence in muscle to exit this crisis stronger taking advantage of all potential opportunities to grow in all business areas.

Our recent investment in cyber security is very much aligned with Embraer's strategic plan. It is an area with several business opportunities and great growth potential in the coming years in which the company intends to expand its operations in Brazil and abroad.

We also continue to pursue potential partnerships to help us to introduce our state-of-the-art products in new markets and develop new projects such as a next generation turboprop aircraft. Finally, we are starting to see positive signs pointing to a recovery in some markets in the second half of the year. Regional aviation has been a key element in maintaining essential services and airline networks during the crisis.

Some airlines are already gradually resuming commercial flights using e-jets in the United States, Europe and other parts of the world. It is also important to note that our relationship with our customers remains strong. We have been working very closely with them in order to better understand their present needs and overcome challenges building a win- strategy based on confidence and collaboration.

The company has developed innovative solutions for a better use of the current fleet and to enhance the safety of the cabin environment. Now aircraft such as solutions to transport cargo in the cabin of commercial aircraft and enhanced cleansing procedures to sterilize passenger's cabin.

In addition, the areas of business aviation and defense has shown greater resilience. In the United States business aviation activity is already approaching 2019 levels and in the defense area, we have several activity sales campaigns with opportunities for the C-390 millennium in the Super Tucano worldwide.

With that I conclude my remarks and would like to pass to our CFO, Antonio Garcia. Thanks for your attention.

Antonio Carlos Garcia {BIO 21338149 <GO>}

Thank you, Francisco. Now moving to the financial highlights at slide five.

Embraer is operating during an unprecedented aviation market slowdown caused by the COVID-19 pandemic. The impact of COVID were meaningful during the second quarter and were mostly concentrated on the commercial aviation. The commercial aviation business experienced low volumes with only four deliveries that generated excess capacity either a cost that were recognized in our financial results instead of going to the inventories.

And adding to the one-off impairments of 90 million and one-time depreciation of 100 million related to 2019 when commercial aviation business was booked as available for sales. Putting altogether, we have a non-recurrent events of almost \$200 million in the commercial aviation results during the second quarter of 2020. Explaining the majority of our soft numbers which we don't expect to see again in the following quarters. The COVID impact on the executive jets and defense business were much lower and our guidance for 2020 will remain suspended even though we already start to see initial improvement signs and expect much better performance in particular for the fourth quarter of 2019.

Despite of all challenge faced during the first half, our performance in executive jets and defense and security had a meaningful improvement when compared to 2019. As we promise last year, several initiatives such as cost control, price discipline, rightsize production and to enter into several new products such as Praetor and the C-390 Millennium are already helping and we will continue to help our financials in executive jets and defense.

Some other financial highlights that we will detail during this presentation includes a stronger backlog with a zero cancellation in commercial aviation. In regards to Embraer cash management team who have been meeting daily to discuss our financials and identify potential cash opportunities for Embraer and so far we already mapped approximately \$800 million in cash savings for this year implemented or to be implemented in the coming months with a meaningful reduction in investments, selling, general administrative expenses and overall costs, a detailed planning to optimizing Embraer working capital in the following quarters.

Additional funds recently secured of 700 million to further improve our cash liquidity in the second half of 2020 and '21 and at the end we are quite proud to reaffirm that we end up with the monitorship and its financial cost impact at the Embraer.

Turning to slide six on highlights for our commercial aviation business. We have been working to integrate the commercial aviation business and prepare the future steps of this very important business unit. As part of the integration process of -- into Embraer we recently announced that Arjan Meijer, previously the Chief Commercial Officer of Embraer commercial aviation, has become the new President and CEO of the commercial aviation business reporting directly to our Group CEO, Francisco Gomes.

We believe the future of the business is in good hands with Arjan, we are excited about this who brings extensive commercial and operating experience from both the OEM and the airline sides. I would like also to take this opportunity to thank John Slattery for his time and hard work here at the Embraer and wish him good luck in his new role at General Electric.

During the quarter, we deliver for e-jets and nine in the first half of the year. We saw deliveries being impacted by COVID-19 and its effect in the airline industry. It's important to note that we didn't suffer any cancellation in the commercial aviation since beginning of this year.

One of our recent deliveries was the aircraft number 1,600 of the e-jets program and E190-E2 for Helvetic Airways underscoring the great success of this family of jets. During the second quarter, Helvetic also upgraded an order of four E190-E2 to the bigger 195 E2s to better serve their future growth needs.

Congo Airways also upgrade an order of two 175 E1 aircraft to the 190 E2. Take advantage of the best-in-class performance of the E2 family. Although we are not in point where we can give our guidance and expect a deliver of our financial performance due to the uncertain caused by the COVID. I'd like to point out that we are culturally optimistic for the future as we have seen the rebound in domestic flights activity in several markets around the world.

As an example, you could see in the chart on the top of the right side 175 E2 service in US is already 90% in July mid of July in services. And if you see the graph below on the right hand side, you see that information of IATA showing that we do have, I would say, flat u-shape recover that we are going to suffer 2020, 2021 but in fact we do see a fast recovery path for the domestic RASK, which we do believe is going to impact also our regional and e-jets aviation products.

Now moving to executive business jet at slide seven. We delivered a total of 13 jets during the second quarter. With nine of them being a light jet and four of them large jets. The jet delivered in the first half of 2020 were 22 aircrafts during the quarter. We delivered the first Phenom 300E showcasing our ability to maintain the competitiveness of our products making the best selling aircraft in the light segment even better. The enhanced Phenom 300E is faster, quieter and received several other upgrades including of avionics and e-flight connectivity. We also announced several breakthrough cabin enhancement for our Praetor families of jets. Consolidated the Praetor's position as the best cabin environment among all medium jets with the lowest cabin altitude in the class and 100% fair share capability with stand features in all Praetor's aircraft.

Further, we announced this week, the launch of the Phenom 300MED, a unique medevac solution which is also available for retrofit and the existing Phenom 300S and it's designed an ideal magical solution for both executive and defense applications. We would like to reinforce that now with the COVID pandemic, we are even more committed to maintain price discipline and rightsizing production plans to meet the current business jet market demand.

Although we cannot give guidance at this time, we are confident that we will have a much stronger second half in deliveries of executive jets and you have seen very few deferrals even less cancellation so far with highly committed customer to their orders.

Finally as far the business jet flying activities we have been seeing significant improvement since April. As shown in the graph with the number of jet flights worldwide returning faster 2019 pre-COVID level. In April business aviation activity was 65% lower than 2019, which improved to 44 lower in May and 23 lower in June. The preliminary figures in July had been trained to only around 10% to 15% lower than last year, which give us confidence of a V-shape recovery in this segment of the market.

On slide number eight we show the highlights for our defense and security segment. During the second quarter, we deliver the third KC-390 to the Brazilian Air Force. And this aircraft have been very important in the country's humanitarian missions to combat the COVID-19 pandemic, presenting a very high dispatchability in the transport of supplies cargo and troops. There are currently five KC-390 Millennium in various stage of production for deliveries to both Brazil and Portugal Air Force.

With one additional delivery expected to the Brazilian Air Force still in 2020. The develop of the Portuguese version of the C-390 Millennium aircraft also reached an important milestone recently entering in the preliminary design review phase. Other highlights in terms of deliveries during the period where the delivery of the first Super Tucano for the Nigerian Air Force as well the last six M60 radar units for the Brazilian Army related to Brazil surveillance of the border program.

Finally we also signed two contracts for acquisition in the cyber security space in Brazil make our continuous diversification of defense and security business into a highly strategic and fast growing segment.

Now turning to the service support business at slide number nine. In the mid of the COVID pandemic, our people have been working hard to create innovative solutions in services and support allowing remote training with full qualification and certification capability, development off a cargo transportation solutions for the ERJs and E-Jets and enhanced cleansing procedures for disinfecting aircraft.

Our service support business also successfully completed the first conversion of a Legacy 450 to a Praetor 500 aircraft. Adding more than 400 nautical miles of a range to the plan among other improvements. The conversion are taking now place at two service centers, in US, one in France and one in Brazil. We are also proud to announce that the Phenom maintenance schedule was extended to 800 flight hours which is twice the industry average, helping our customer to avoid the unnecessary spend on aircraft maintenance.

And in Portugal, our OGMA subsidiary signed 12 new contract for maintenance and repair across commercial, defense, executive customer during this period. Finally, we show an update on the right hand side about the Embraer global fleeting service. As you can see since April our service has already increased a lot and reached approximately 70% utilization in July, which is a significantly above other aircraft model.

Moving onto our financial results for the period down to slide 11. Our backlog finished at \$15.4 billion remaining strong and represent several years of revenue for Embraer. It's important to highlight again that despite some deferrals we didn't have any cancellation in commercial aviation and we have several activities in campaign right now that may support a backlog expansion in the upcoming quarters.

Moving to slide 12, we show our aircraft deliveries. As mentioned previously, we delivered for commercial jets in the second quarter roughly in line with our deliveries for the first quarter. With the COVID-19 pandemic significantly impacting our deliveries in this segment. Our guidance will remain suspended, but we expect a better delivery performance during the rest of the year.

Our executive jets business has less of an impact from COVID and we delivered a total of 13 aircrafts in the second quarter. With our high quality backlog following a strong year of sales in 2019. We are confident that the executive jet delivery will continue to increase in the second half of 2020 as our customer continues to reconfirm their upcoming delivers.

At slide 13, we show our net revenue on a consolidated basis. With second quarter coming in at \$537 million, the net revenue declined during the second quarter affected all of our business segment due to the COVID, but commercial aviation and its related service were particularly impacted representing almost 70% of this total revenue decline during the quarter.

Next slide 14 selling and administrative expense to continue to decline in the second quarter helped by several actions taken to gain efficiency and spend as well as the furloughs and salary reduction measures took and concentrate in the second quarter. It's important to mention that selling expenses include 60 million in additional bad debt provision compared to last year second quarter mostly on commercial aviation customers.

Excluded this provision selling expense would have been even lower comparing to the level recognized in the second quarter of 2019. At slide 15 we show operating results. Embraer reported adjusted EBIT of a loss of 141 million in the second quarter of 2020 with a margin of minus 26%. It's important to highlight that the executive jets, defense and security and related services and support reported EBIT numbers close to our break-even during the first half of 2020 and commercial aviation was really the segmental responsible for the negative operating results during the first half, which is a reflection at a very few deliveries due to the COVID-19 and the January shutdown for the segregation of the commercial business into a separate entity.

As already anticipated despite the COVID challenge executive aviation defense has been showing a meaningful improvement versus the first half of 2019. Due to price discipline improved mix and lower cost base revisions.

Finally the adjusted EBIT in the second quarter excluded a total of 200 million in non-cash special items mostly related to the commercial aviation include impairments of the E-Jet family and the recognition of the depreciation and amortization expenses related to the

quarters when commercial aviation was recorded as a discontinued operation available for sale.

Slide 16 shows our adjusted EBITDA, which was a loss of 120 million and also excluded the special items. I already mentioned in the previous slide adjusted EBTDA margin was minus 22.4% for the second quarter also reflecting the pressure on profitability coming from few deliveries in commercial aviation during the period with executive jets, defense and security services reporting much better numbers.

Moving to the next slide 17 with earnings. Embraer adjusted net income reached a loss of 199 million in the second quarter implying a negative margin of 37% for the quarter. Our earnings have been negatively impacted by the combination of lower deliveries and revenues and a higher separation cost similar to the impact already shown in the EBIT and EBITDA and higher financial expenses.

Our reported net income was much bigger loss of 350 million, but mostly driven by the previously mentioned non-cash special items, partially offset by the lower differ income taxes items. We expect to show much better bottom line performance in the second half as deliver margins is starting to improve during the rest of the year.

Moving to slide 18, which shows Embraer investment over the last several quarters. The company has launched initiatives toward this investment including CapEx as well research and development. This reflects our actions to minimize non-essential investment to preserve cash flow in the contest of the pandemic. Its also reflects updated portfolio with state-of-the-art products in commercial aviation, executive jets and defence and security.

Embraer has invested a lot in the last five years bringing new programs and products to the market and now we expect the coming years to show lower investment. We have also announced a new timeline of the entry into the service of the 175 E2 now in 2023 with that our CapEx development spending related to this program can be also better spread into the next two or three years.

So assuming that it's not so easy to talk about profit and loss during this quarter, let's talk about cash flow moving to slide 19. Our free cash flow was usage of 476 million in the second quarter. The free cash usage was primarily impacted by lower commercial aircraft deliveries in the quarter leading to lower profitability and higher working capital needs especially due to higher inventories. This impact were partially offset by lower investment spend and other actions taking to reduce cash outflows sets higher focus on accounts receivables and payables.

Several working capital and expenses control throughout the second quarter were able to reduce our cash consumption compared with the first quarter, and we are confident that our free cash flow will continue to be much better in the second half of the year particularly in the fourth quarter with the high deliveries and the working capital reduction leading to these improvements.

Finally slide number 20. We are happy to show our liquidity position. We would like to highlight that despite two quarters of a cash burn, our liquidity position remains solid as well finished the second quarter with 2 billion in cash.

We also recently signed an additional financial contract with Development Bank in Brazil, private and public banks for an additional 600 million as well and other 100 million supported by the US Exim Bank of a total of 700 million of additional liquidity coming mostly now in the third quarter.

This incremental liquidity combined with higher expected delivery give us a comfort to maintain our solid liquidity throughout the end of this year and into 2021. Our debt maturity are also mostly concentrating 2022 and beyond that in an average maturity of almost four years. And again we are quite happy that how we are treating, how we are preserving cash in our liquidity and give the comfort that Embraer remains strong and we are prepared for any kind of change in the market fast recover any kind of second phase of COVID and make sure that you have a good solid liquidity position towards the future.

With that I conclude my presentation. And I'd like to pass to Francisco for his closing remarks before you open to the Q&A session. Thank you.

Francisco Gomes Neto {BIO 19328044 <GO>}

As you saw in the presentation we had a very difficult first half heavily impacted by the COVID-19 crisis and the redundancies in the commercial aviation business. At the same time, as I mentioned earlier, we are already taking the necessary actions to regain synergies and adjust the company to the COVID-19 scenario and to guarantee the execution of our '21, '25 strategic plan.

We may still face some challenging month ahead, but I am very confident that we will get at the end of this year much stronger and well prepared for a sustainable future. I'm really proud of all the effort made so far as the Embraer leadership team is united and focused to do what needs to be done to allow this great company to succeed.

That together with the continued support of our customers, suppliers and investors we will make Embraer to emerge even stronger from this turbulent times. Thank you.

Questions And Answers

Operator

Ladies and gentlemen, we will now begin the question-and-answer session from investors and analysts. (Operator Instructions) Our first question comes from Mr. Myles from UBS.

Q - Myles Walton {BIO 6802513 <GO>}

Thanks. Good morning, Francisco, Antonio Garcia. Could you maybe go over a little bit about the cash in the second half. You had previously talked about wanting to maintain \$2

billion of liquidity at all times and you have always taken out some debt here. As you look to the second half is it still a burn in the second half on the order of low number or is it a positive in the second half from here?

A - Antonio Carlos Garcia {BIO 21338149 <GO>}

Hello, Myles. Thanks. It's a good question and we -- I do believe we are going to stay in the same level at the end of this fiscal year because historically the seasonality of our business always very hard in the third and especially in the fourth quarter where we have our revenues and the cash inflows I would say more or less stable to the end of this fiscal year.

Q - Myles Walton {BIO 6802513 <GO>}

Okay. So break-even free cash flow for the second half?

A - Antonio Carlos Garcia {BIO 21338149 <GO>}

Yes.

Q - Myles Walton {BIO 6802513 <GO>}

Okay. And then in terms of the operating margins in the segments. I imagine commercial was the largest drop here, but can you give us some more color on the operating margins of executive and defense and within defense I think you took a charge in the KC-390 to reset the cost base. Can you just elaborate if that's what size of that?

A - Antonio Carlos Garcia {BIO 21338149 <GO>}

I'm going to pass this to Eduardo. Eduardo please go ahead.

A - Eduardo Couto {BIO 18009973 <GO>}

Yes, I can give some color, Antonio. Yes, on executive jets, Myles, we did very well in the first half. We had break-even margins despite lower deliveries and as we show in the charts the deliveries are picking up. So I would say second half should be quite interesting for business jet.

So around break-even margins in the second quarter and first quarter. So good numbers in executive especially compared to the previous years when we are suffering much more with the product mix. I think we are able to improve that a lot with the Phenom -- with the Praetors and also with price discipline rightsizing the production a lot of measures that Michael is implementing on the business jets.

In defense, of course, you know there is some seasonality, but we prefer to look the first half as well and defense margins in the first half were also break-even, which we believe are good news as we have highlighted in the past, there was a lot of focus to improve margins in executive and defense and we are really showing that.

So the drag on the margins -- they really came from commercial and now we had very few deliveries and that affected the margins. So once commercial deliveries start to recover the expectation is margins is ready to pick up in the upcoming quarters.

Q - Myles Walton {BIO 6802513 <GO>}

Okay. All right. Thanks. I'll leave it to you. Thanks.

A - Antonio Carlos Garcia {BIO 21338149 <GO>}

Thanks, Myles.

Operator

Our next question comes from Mr. Ron from Bank of America.

Q - Ronald Epstein {BIO 4430430 <GO>}

Yes, good morning, guys.

A - Antonio Carlos Garcia {BIO 21338149 <GO>}

Hi, Ron.

Q - Ronald Epstein {BIO 4430430 <GO>}

I was wondering if you could maybe characterize how the conversations are going with airlines like you mentioned you said you haven't seen any cancellations, but how does deferrals look and when do you expect some airlines to begin to take more commercial airplanes?

A - Francisco Gomes Neto {BIO 19328044 <GO>}

Hi, Ron. Thanks for the question. I would say, I guess, we have the conversation about deferral was -- it was highly concentrated between March and April and it's still I would say the same situation right now. For sure we are having a lot of conversation with the airlines and for a lot of negotiations and a lot of discussions are ongoing.

I cannot assure that the market recover is going only in favor of the regional jets with again we do have a lot of campaigns in the field right now. And also in regards to change models, change the setup of more regional domestic then I would say big airplanes in the summary deferrals stop and we are just talking about new campaigns that again we are having a lot of requests and I cannot make sure that's a trend, but I would say we do have a good feeling. I don't know if I answered your question as you want to but.

Q - Ronald Epstein {BIO 4430430 <GO>}

Yes, I think, that's helpful. How is demand for the E175 been now that E2175 has been delayed. I mean you've seen demand for that pickup?

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A - Antonio Carlos Garcia {BIO 21338149 <GO>}

The main deferral was highly concentrated in 195 instead in the 175, 175 I would say most of the customers they are still committed to pick -- to take the aircraft especially the US customers.

Q - Ronald Epstein {BIO 4430430 <GO>}

Got it, got it. And then maybe one last question if I may. The business environment seems to be doing better than you guys have alluded to that in the second half, we could see a pickup in deliveries. How are those conversations going? And what -- when you look at the customers, there is no reticence to get airplanes around the economy. Are they looking at business aviation as a secure -- more secure way to travel given the pandemic if you could maybe offer some more color around what those customers are thinking?

A - Antonio Carlos Garcia {BIO 21338149 <GO>}

Yes, it's a good question. How you see today the fleet -- in the fractional owners even the fractional flights. They are quite busy with the traffic today and what we are seeing right now I cannot say it's a trend that we are having a lot of I would say privately owned jets being bought right now and again the fleet in the fractional owners they are really evaluating how to go forward and I would say stable with a slight positive trend especially in the private-owned jets, but we cannot make sure 100% that because of the COVID the pandemic that regional aviation is going to be bigger than last year, but I would say if you see the graph we display, we are very close to the levels of 2019, but the replacement of the aircraft is still I would say under evaluation what I can make sure historically our second half for the executive jet is very strong compared on the first half.

A - Francisco Gomes Neto {BIO 19328044 <GO>}

Hi, Ron. It's Francisco speaking, yes, maybe perhaps the COVID that brings us more opportunity for the executive aviation in 2021 as well.

Q - Ronald Epstein {BIO 4430430 <GO>}

Got it. All right. Thank you very much.

A - Antonio Carlos Garcia {BIO 21338149 <GO>}

Thank you, Ron.

Operator

Our next question comes from Mr. Robert from Credit Suisse.

Q - Robert Spingarn {BIO 5996882 <GO>}

Hi, good morning. Just on the last question that Ron asked on executive aviation as you see opportunity perhaps in the second half where do you see it? Is it at the Praetor level, at the Phenom. Any color on the interest levels?

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A - Francisco Gomes Neto {BIO 19328044 <GO>}

Robert, thanks for the question. The Phenom 300 continues to be our best seller and where we have I would say highest potential of sales, but also we are quite optimistic with the Praetors as well.

Q - Robert Spingarn {BIO 5996882 <GO>}

Okay. And you talked about the stronger second half because of higher deliveries across the commercial portfolio, executive jet portfolio. How good is the visibility here? How reliable are these deliveries and the customers?

A - Antonio Carlos Garcia {BIO 21338149 <GO>}

I would say for the, Robert, for the commercial aviation again we, for sure, have talks every day for customers, but what you see for the second half of the year is confirmed, okay. And there should be no change or no big surprise maybe with even upside potential. And the executive aviation I would say big portion of the second half is already sold. It's just to deliver and we still have just few white tails to be sold in the second semester.

Q - Robert Spingarn {BIO 5996882 <GO>}

Okay. And then just?

A - Antonio Carlos Garcia {BIO 21338149 <GO>}

That's why you are confident about the -- what you are communicating to the market right now.

Q - Robert Spingarn {BIO 5996882 <GO>}

Okay. And then longer term question on defense. Given the new areas that you're beginning to pursue and with the product portfolio that you currently have. If we look at a few years, how big do you see the business annually in terms of revenues?

A - Francisco Gomes Neto {BIO 19328044 <GO>}

We are now, as I mentioned earlier, we are now finalizing our '21, '25 strategic plan and we foresee a growth in all business units including defense. Especially in defense we have now campaigns, open campaigns going with the KC-390 with different potential customers. So and we are now working in all the different segments in defense. So we are optimistic that all the BUs especially defense will show important growth in the following years.

Q - Robert Spingarn {BIO 5996882 <GO>}

Okay, thank you very much.

A - Francisco Gomes Neto {BIO 19328044 <GO>}

You're welcome.

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A - Antonio Carlos Garcia {BIO 21338149 <GO>}

Welcome.

Operator

Our next question comes from Mr. Cai Von from Cowen.

Q - Cai Von Rumohr {BIO 1504358 <GO>}

Thank you very much. So if I could follow up with Myles' question. If we're looking for break-even cash flow in the second half, does not assume a big deficit in the third quarter because your fourth quarter historically always has been huge and maybe give us some color on some of the moving part for example the inventories the contract liabilities were down in Q2. I assume you paid off your suppliers. Is that an opportunity that maybe you could move back to more normal levels? Thank you.

A - Eduardo Couto {BIO 18009973 <GO>}

Hi, Cai. It's Eduardo here. I will take that question. Yes, fourth quarter will be for sure stronger than third quarter. We are not anticipating a big cash burn in third quarter. I think third quarter will already be good, but fourth quarter for sure positive. So maybe there is some room for to be positive in the second half, but to be more conservative we're assuming break-even, but definitely fourth quarter stronger and third quarter still more soft.

Q - Cai Von Rumohr {BIO 1504358 <GO>}

Thank you very much.

A - Antonio Carlos Garcia {BIO 21338149 <GO>}

And just to complete, Eduardo. And Cai Just to complete -- in regards to the liabilities with supplier base we still just really few discussion with one or all the suppliers about renegotiation. But I would say the big guys we already discussed and agree how to move forward and with the new volumes we are quite confident to not see any big liability in the second quarter or the second half of the year.

Q - Cai Von Rumohr {BIO 1504358 <GO>}

And then a second question I know that you haven't completed your 2021 to 2025 strategic plan, but if one looks at the history of Embraer you've done an incredible job of developing high performing products both in regional and bizjets now KC-390 and yet you pretty consistently have not generated substantial profits or cash flow for shareholders. As you think about that strategic plan, what kind of priority is there in terms of return to the shareholders and what are you doing to assure that?

A - Francisco Gomes Neto {BIO 19328044 <GO>}

Good question, Cai. I mean, again, it's a combination of actions we are taking, right, I mean in the short-term we are, as we mentioned before, we are focusing on the cash

preservation with all measures, as mentioned before. We are also taking care to adjust the organization in the light of the COVID-19 impact and also due to eliminating the duplications we had to do because of the deal with Boeing.

We are recapturing all the synergies and then you know we are also putting in place a lot of our other projects like to reduce the production cycles of our aircrafts to put more focus on procurement activities to put more focus on material management to work with less inventory and reducing the working capital.

And all of this combined with this future growth that are included in growth -- in the growth drivers of our '21, '25 strategic plan. We believe this will improve a lot our financial performance in the following years.

Q - Cai Von Rumohr {BIO 1504358 <GO>}

Thank you very much.

Operator

Our next question comes from Mr. Gabriel from Bradesco BBI.

Q - Gabriel Rezende {BIO 20589376 <GO>}

Hi, thank you. I have two questions here on my side. I wonder if you could comment a little bit on the higher operational expenses in the services and support division? And also my second question, there has been a lot of news in the media regarding layoffs. Could you comment a little bit on that? I mean how are negotiations with labor unions evolving?

A - Francisco Gomes Neto {BIO 19328044 <GO>}

Yes, maybe I can take the first one regarding services. Yes, the service business especially in commercial were also affected in the second quarter, right, given lower activity as we show in the charts especially April was a very soft month in terms of flight operations. April and May and that affected the fixed cost dilution of service and that was reflected in the second quarter numbers, but as the activity is returning, we believe service will have a better numbers in the second half. We also had some bad debt provisions, right, in services that effected the cost in the second Q.

A - Antonio Carlos Garcia {BIO 21338149 <GO>}

Gabriel, could you please repeat the -- your second question?

Q - Gabriel Rezende {BIO 20589376 <GO>}

Yes, sure. It was regarding layoffs and negotiations with labor union?

A - Antonio Carlos Garcia {BIO 21338149 <GO>}

We are working this restructuring program. We have -- we decided to start in the upper level with the vice presidents. So we made some important changes there, as I

mentioned before. And we also did -- we went out to the second level of directors and managers and make some changes in the adjustments in that -- those levels and now we are -- we are studying the following levels. In parallel, we opened this PDVs, the voluntaries (inaudible) program to help us in this process. So now we are going by step by step, I mean, in this restructuring program, that's our plan.

Q - Gabriel Rezende {BIO 20589376 <GO>}

Okay. That was helpful. Thank you.

Operator

Our next question comes from Mr. Noah from Goldman Sachs.

Q - Noah Poponak {BIO 16071528 <GO>}

Hi, everyone.

A - Francisco Gomes Neto {BIO 19328044 <GO>}

Hi, Noah.

A - Antonio Carlos Garcia {BIO 21338149 <GO>}

Hello, Noah.

Q - Noah Poponak {BIO 16071528 <GO>}

Is it possible to attempt to quantify or give a little bit more detail on your production and delivery mismatch. I assume you're producing ahead of deliveries as you field near-term deferrals. And so I'm just wondering how many aircraft built, but not delivered, did you end the quarter with, and how much of that will you flush through the inventory by the end of the year or how many will you end the year with in commercial?

A - Francisco Gomes Neto {BIO 19328044 <GO>}

Yes. It's for sure we have higher inventories that we would expect, given the low volume of deliveries that we had in the second quarter. It's tough to give a number, right but our total inventories are around 3.2 billion and it could be above 100 million lower if we're delivering the planes as initially planned. So there is room in the second half will show as we pickup the delivers. We expect a good reduction right in terms of inventory that will translate in cash, but it's tough for us to quantify a number because sometimes the planes are really close to conclusion in the production line, but we still show them as work in progress.

So we -- it's tough to give a number of how many planes are ready, but we have a good size of inventory in commercial for second half.

A - Antonio Carlos Garcia {BIO 21338149 <GO>}

Just to complete. Good question. We were, I would say, prepare before the crisis to produce around 100 aircraft and with the slowdown and deferrals, we should not see more than a half of this number and that's impact our inventory, in many cases, that's why we do have this 3.2 billion inventory that is our opportunity to continuously reduce to the second half of the year and with the addition of the deliver that we do see historically for the second half of the year.

Q - Noah Poponak {BIO 16071528 <GO>}

Okay. So would you expect to end the year with that production and delivery mismatch gone you know and everything lined up. And then you just reset production for next year although you move into 2021 with some lingering inventory from this year?

A - Antonio Carlos Garcia {BIO 21338149 <GO>}

I would say we are moving a little bit inventory for next year. We are revising the supply chain and the material have in a daily basis, okay, but we should have some especially in commercial side, some carryover for 2021, not huge because we did a great job to reprogramming raw material, but material have already in our inventory that is still continue to be to 2021. Then with the new schedule for 2021 and we are going to get rid of this excess material.

Q - Noah Poponak {BIO 16071528 <GO>}

Got it. And then when do you expect to be able to pretty confidently said that 2021 production plan both on the commercial side and the executive side. I mean are you kind of already there now because you've had enough of an evolution in your customer conversation or is it still so uncertain out there that you're not yet really that close to knowing where you want to put production for next year?

A - Antonio Carlos Garcia {BIO 21338149 <GO>}

We do have already a number for next year that we set our production of our material program. We have the, I would say, the latest revision change in late August to be done, but we set already I would say with some conservatism here with some be more feet on the ground, we set our number for next year, and if there is a change it can be only an upside potential. We are quite conservative for the numbers for 2021. Maybe Francisco want to comment in addition?

A - Francisco Gomes Neto {BIO 19328044 <GO>}

No, that's what we are doing, Noah, we are trying to be conservative for the plans for next year, but adjusting the organization to that -- to those deliveries we are planning for next year. This is what we are doing.

Q - Noah Poponak {BIO 16071528 <GO>}

That's helpful. What I'm trying to get it is your level of confidence in that right now as you speak to us substantially higher than it was when you last reported results to us because there's been enough firming up with the customers or is it still is it not really that different than the last time you spoke to us because there's so much uncertainty still out there.

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A - Antonio Carlos Garcia {BIO 21338149 <GO>}

We are much more confident when you have the latest call. However, you know, we are still having this credit facility, which is not available for our airlines. I would say if I would see constraints is related to the credit, but in regards to the schedule for next year the programs we have, we are much more confident than three months ago.

Q - Noah Poponak {BIO 16071528 <GO>}

Okay. Thanks so much.

A - Antonio Carlos Garcia {BIO 21338149 <GO>}

Welcome.

A - Francisco Gomes Neto {BIO 19328044 <GO>}

You're welcome.

Operator

Our next question comes from Mr. Ron from Bank of America. Mr. Ron, you may proceed.

Q - Ronald Epstein {BIO 4430430 <GO>}

Yes, sorry about that, I was on mute. How has interest from China been? Have you seen a pickup in interest in commercial airplanes or even business aircraft from the Chinese market?

A - Francisco Gomes Neto {BIO 19328044 <GO>}

We are wrong, actually, we are working in several fronts looking for potential partnerships to help us to introduce our state-of-the-art products in new markets and also to help us to develop specific projects as a turboprop, but to be very honest with you, we don't have yet any concrete result to be and to open to the market, but we are working very hard on those fronts. I'm personally involved in following those fronts up in a biweekly basis, but we don't have any concrete to share with you any concrete news to share with you so far.

Q - Ronald Epstein {BIO 4430430 <GO>}

Okay, thank you.

Operator

This concludes today's question-and-answer session. That does conclude Embraer's audio conference for today. Thank you very much for your participation. Have a good day.

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