

Q3 2020 Earnings Call

Company Participants

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

Other Participants

- Augusto Ensiki, Analyst
- Cai von Rumohr, Analyst
- Mariana Perez Mora, Analyst
- Myles Walton, Analyst
- Noah Poponak, Analyst
- Robert Spingarn, Credit Suisse
- Unidentified Participant

Presentation

Operator

Good morning, ladies and gentlemen, and welcome to the audio conference call that will reveal Embraer's Third Quarter 2020 Results. Thank you for standing by. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session, and instructions to participate will be given at that time. (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 the 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.

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conference call might not occur. The Company's actual results could 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, Chief Financial Officer and Procurement; 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, sir.

Francisco Gomes Neto {BIO 19328044 <GO>}

Good morning, everyone. Thank you very much for participating in this conference call. I am Francisco Gomes Neto, President and CEO of Embraer. Before giving the floor to Antonio Garcia, our CFO, I would like to make some initial comments. With the recent growth in the number of COVID-19 cases in different parts of the world, notably in Europe and in the United States, we remain focused on the health and safety of our people, assessing the situation on a daily basis at each of our units around the globe.

Regarding finance, our focus in the short-term remains on preserving cash through the execution of a series of measures implemented over the past few months, which I have already discussed with you during our past earning calls. In parallel, we are preparing the ground for a much better financial performance in 2021 and grow [ph] in the following years. Today, I would like to take a few minutes to focus on some of our priorities, namely a lean organization and recapture synergies and business plan update.

Next Slide please. Regarding our lean organization and recapture synergies pillars, we have made every fort [ph] to maintain the know-how and competitive advantage brought by our remarkable people, but in view of the new market reality, it has become essential to review our workforce. And in the last quarter, we made a significant adjustment to our structure.

We analyzed the structures and themes of each area within the Company with the goals of creating a leaner and more agile organization and eliminating the duplications generated by the Commercial Aviation carve-out. We have already recovered synergies with the reintegration of Commercial Aviation and the associated services and supports, and at the same time, we have retained all the SKUs necessary to return to growth in the coming years.

A simpler and leaner organization has been prepared for properly implementing our '21-'25 strategic plan, a theme that we will address on the next slide. While we are dedicated to managing the impacts generated by the crisis in the short term, over the past few months, we have also focused on updating our business and growth plan. We believe that the period between now and 2025 can be divided into three phases. This year is dedicated to crisis response. Starting next year, we expect that the market will start to recover, with variations depending on the specific business areas and markets. And from 2022 onwards, our projects will mature and allow us to grow profitably.

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Regarding the Embraer '21-'25 strategic plan, we have reviewed the details over the past few months in response to the new market scenario, including the impacts generated by the pandemic, the end of the agreement with Boeing and the reintegration of Commercial Aviation. This was a collaborative effort, evolving dozens of company leaders. We focused on the plan's effectiveness and we know it is realistic. The goals are challenging but doable and we will execute with focus, governance and discipline.

The plan has two main objectives: to increase revenue and to improve profitability. To achieve these two objectives, we defined the three lines of action. Number one, initiatives aimed at efficiency gains. Number two, actions to increase the sales of our current product portfolio. And number three, a combination of business diversification projects, innovation and strategic partnerships. In total, the plan comprises 18 projects that will bring more agility and intelligence to the processes and reinforce alignment across the Company.

Just to give you a little more visibility, the first front, which is related to efficient gains entails the creation of a world-class purchasing organization reporting to the CFO and focusing in a very structured way on intelligent cost reduction. At the same time, we are incorporating more intelligence into the processes within the material planning and logistics area focusing on increasing inventory turn reduces substantially working capital.

In operations, the projects aim to reduce aircraft production cycles, which will allow us to have more competitive products and reduce the working capital as well.

Regarding the second front dedicated to the growth of portfolio sales, we will densify the sales force of our products, it benefits from new and competitive products in every segment in which we operate. Additionally, we will focus on adapting and converting aircraft for specific segments such as converting e-jets to carry cargo in the passenger cabin or the recently launched Phenom 300MED, which was designed for Medical Evacuation.

Finally, on the diversification, innovation and partnerships front, we are going to expand our operations. This year we have already announced investments in cybersecurity, with the acquisition of Tempest, the Frigate project with the Brazilian Navy, and more recently, the creation of Eve, a company dedicated to the development of the Urban Air Mobility ecosystem and eVTOL, Electric Vertical Landing and Takeoff aircrafts. With these fronts, we are also developing project to expand our service offerings for aircraft from other manufacturers and we are discussing potential strategic partnerships aimed at opening new markets and developing new products such as the turboprop.

It's important to note that in addition to managing the way we structure the projects, the plan focused on the process of execution and on the constant monitoring of the evolution of all initiatives. We are aware of the challenges we have ahead, especially in Commercial Aviation in 2021. But we are very confident in the future of Embraer. We know what must be done, we know how the plan should be carved out. And we have an immensely competent and aligned team that would develop the necessary initiatives to make the Company grow profitably in the coming years.

With that, I have concluded my comments, and I would like to give the floor to our CFO, Antonio Garcia. Over to you, Antonio. Thank you all.

Antonio Garcia {BIO 21338149 <GO>}

Thanks, Francisco. Good morning, everyone. It's really a great pleasure to talk to all of you.

Now moving to the Commercial Aviation highlights on Slide 7. During the third quarter, we delivered 7 E-Jets, representing a sequential improvement compared to the first and second quarters that will accelerate even more in the fourth quarter. Among our third quarter deliveries, we had five 175s for United Airlines, highlighting our continuous leadership in US regional jet market. As another example of our continuous improvement, we have already delivered more planes in October than in the entirety third quarter of 2020.

As far as new operators, Alliance Airlines from Australia received 14 pre-owned E190s and Bamboo Airways from Vietnam, started operation with two E195. We are still not in the point where we can give guidance on expected deliveries or financial performance due to the COVID-19 uncertainties. But we would like to point out that we remain cautiously optimistic for the future as we have seen a gradual rebound in domestic flight activity in several markets around the world, including United States.

Looking Commercial Aviation 2021, the uncertainties around the COVID pandemic are still our biggest concern for next year. The fleet of 175 new operations continue to improve with 93% in service as of end of September, outpacing our competitors in the market. I'm also proud to say that we had zero cancellation of commercial jets orders since the beginning of the COVID pandemic.

In Executive Jets on Slide 8, we had a strong delivery pick up during the third quarter with 21 deliveries. This brought the total Executive Jets delivered so far in 2020 to 43 aircrafts. We expect the fourth quarter to remain strong for Embraer and deliveries should continue to increase compared to the previous quarter.

As our result of higher deliveries, improved mix and measures taken to be more cost-efficient, the Executive Jets segment posted positive operating margins in the third quarter and year-to-date, marking the continuous turnaround of our profitability on this segment despite the COVID-19 pandemic. Also as mentioned in the last call, we launched the Phenom 300MED, during the third quarter, which is a unique MEDEVAC solution that's also available for retrofit on existing Phenom 300s.

In terms of new technology, Embraer continues to disrupt the major segments with Praetors now being standard while the lavatory electric door and synthetic vision system were both certified during the quarter.

Finally, we would like to highlight the continued recovery [ph] during the third quarter. In particular, with respect to the fractional and charter operation which has [ph] smaller and medium jets, among fractional small jets activities was down only 13% year-over-year

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compared to the medium jets down to 18% and larger jets 33%. Among charters, small jet activities was almost flat versus last year while the medium and larger jet class were down 5% to 17%, respectively. As you can see, the markets [ph] where Embraer is positioned with the Phenoms and Praetors are recovering faster.

Moving to Slide 9, we show the highlights for Defense and Security. Regarding the C-390 Millennium program, there are currently six C-390 in various stages of production for future deliveries to Brazil and Portugal and we expect to deliver one more aircraft to the Brazilian Air Force still this year. The program also received the 2020 and Grand Laureate awards for defense from the Aviation Week which selects the best aircraft programs across [ph] Commercial, Executive, Defense around the world. Another highlight during the quarter was Super Tucano as Embraer was able to deliver 10 planes to international customers. With the reopening of global borders, we were able to deliver Super Tucanos to Nigeria, Chile and the Philippines.

Finally, the First Gripen E, arrived in Brazil to start its flight-test campaign, which is a major milestone in the Brazilian jet fighter program with Saab. Embraer will also play a leading role in the execution of the program in Brazil and we will be responsible for the systems development. Integration flight testing and final assembly and delivery of the aircrafts to the Brazilian Air Force.

Now turning to services and support on Slide 10. We are proud to say that Embraer once again was ranked first in Pro Pilot's Corporate Aircraft Product Support Survey in 2020, underlining our commitment to customers to provide the best after-sales support possible. Our services and support team also completed the 7th Conversion of a Legacy 450 to a Praetor 500, since the service became available earlier this year. We were also able to get the certification in the third quarter of the first E-Jet modified for a cargo transportation in cabins, offering our customer a solution to better utilize their fleets in the environment of lower passenger traffic caused by the COVID-19 pandemic.

Further in servicing, we are pleased to see that the C390 Millennium has been showing excellent reliability in the military missions in Brazil and abroad.

Moving on to our financial results on the Slide 12, our backlog finished third quarter at \$15.1 billion, representing 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 expect to some new sales to potentially lead for a backlog expansion in the upcoming quarters depending on the impacts of a second COVID wave in certain regions.

On Slide 13, we show revenues and deliveries. We can clearly see an improvement in the third quarter relative to what we had in the first half of the year and the impacts of COVID on the industry start to reduce with higher Commercial and Executive Jets delivered in the quarter.

As I mentioned earlier, we expect an even better fourth quarter compared to the third quarter. We also had a strong revenue improvement in Defense & Security following the opening of international borders to allow for the deliveries of Super Tucanos. Our services

and support business, despite a year-over-year decline due to the COVID-19, has also increased double-digit sequentially from the second quarter with the (inaudible) improved activities across the Commercial, Executive and Defense markets.

Next on Slide 14, and by highlights, its continued cost control in selling and administrative expenses. The reduction of SG&A reflects our ongoing efficiency and (inaudible) actions [ph], as I mentioned earlier in this presentation. Combined of course lower market [ph] expenses coming from the COVID-19 restriction.

It is important to mention that selling expenses includes higher bad debt provisions compared to last year, mostly related to our services and support receivables. Excluding the bad debt provision, SG&A expenses on a year-to-date basis in 2020 are 30% lower than the same period of 2019.

On Slide 15, we show our operating results. Embraer reported adjusted EBIT of a loss of \$45 million in the third quarter with a margin of minus 6%. The adjusted EBIT in the third quarter excluded a positive impact of \$7 million for special items including \$54 million in charge related to our restructuring announced in September and \$13 million in additional bad debt provision, offset by \$75 million positive in reversal of non-cash impairment charges in Executive and Commercial Aviation.

Breaking our third quarter margin by business. Executive debt was positive 2%, services and support 4% [ph] positive, Defense & Security breakeven similar to previous quarter. Commercial Aviation was in response for the negative operating results due to the low deliveries and the COVID impacts.

So in Slide 16 shows our adjusted EBITDA which was a loss of \$80 million and also excluding the special items already mentioned the previous slide. Adjusted EBIT margin was minus 1%, the combination of better volumes and cost-cutting initiatives have already started to appear in the third quarter and we expect this trend to accelerate in the fourth quarter of the year.

Moving to next Slide 17, with earnings. Embraer Adjusted net income reached a loss of \$148 million in the third quarter. Our earnings have been negatively impacted by the lower operating results as well as higher financial expenses and no cash FX losses. Similar to the operating numbers, net income also reached a bottom in the second quarter and has started to rebound and we expect better bottom line performance in the fourth quarter of this year, driven by higher deliveries.

Next slide, is Slide 18, we show Embraer's total investment over the last few quarters. The Company has launched several initiatives to cut investments, including CapEx as well as research and development. This reflects our actions to preserve cash. It also highlights Embraer updated portfolio with state of art products in Commercial Aviation, Executive Jets, Defense & Security.

Embraer has invested a lot in the last five years, bringing new programs and products to the market and now we expect (inaudible) to show lower investments. Total investment

during the third quarter reached \$45 million and \$134 million year to date, which is less than half of our investment level of 2019.

Moving to Slide 19. Our free cash flow was a usage of \$567 million in the third quarter. This free cash flow usage was negatively impacted by approximately \$250 million including three major items. First, one-off charge of around \$70 million related to the restructuring and severance package of our headcount reduction in the beginning of September.

Second, our \$100 million in short-term customer finance that will normalize now in the fourth quarter. And third, another \$80 million related to three plants, that skipped from the end of the third quarter to the fourth quarter. Excluding that, our cash consumption in the third quarter of this year will be very close to the third quarter of 2019.

Giving expectation for higher deliveries in the fourth quarter, positive impact on our working capital as well as our cost reduction initiatives, we are confident that our free cash flow will be much better in the fourth quarter of the year and we should be at least cash breakeven in the second half of 2020.

Finally, on the Slide 20, we highlight our strong cash position. Our liquidity increased during the third quarter with a total cash position of \$2.2 billion, which is a similar cash level that would have prior to COVID pandemic. I'm also happy to announce that we completed three years [ph] of the liability management initiatives, new laws with private and public banks as well new bonds issuance of \$750 million maturing in 2028 and as repurchase of \$250 million of outstanding 2022 and '23 bonds.

It's important to highlight that our new 2028 bonds is unsecured and had a market demand above \$3 billion showing the confidence of the investor in long-term of Embraer.

With that, I conclude my presentation and we can open for questions. Thank you very much.

Questions And Answers

Operator

Thank you. We will now begin the question-and-answer session. (Operator Instructions)

Our first question comes from Robert Spingarn, Credit Suisse.

Q - Robert Spingarn {BIO 5996882 <GO>}

Hi, good morning.

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

Hi, Rob.

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Q - Robert Spingarn {BIO 5996882 <GO>}

Hi. Just a couple of different things. First, what gives you confidence in the outlook at Commercial and Executive Jets for you to reverse these impairments at this time? What improving trends are you seeing? And does that include increased interest in ordering aircraft?

A - Antonio Garcia {BIO 21338149 <GO>}

Rob, it's Antonio speaking. Thank you and good question. The reverse of impairments assuming that we revise it in a quarterly basis, it was highly driven by the exchange rate. The devaluation of the Brazilian real, we do have a lot of cost in reals which means we didn't change volumes [ph] we just changed the exchange rates, improved the margins, which accounts for the impairment reversal, just this. We didn't change the baseline.

Q - Robert Spingarn {BIO 5996882 <GO>}

I see. Are you seeing any evidence of something you've talked about in the past and that we saw after 9/11. Are you seeing actual down gauging at your customers from the Commercial narrowbodies to the E-Jets and is this a trend that is gaining some traction?

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

Rob, Francisco speaking. Thanks for the question. We believe the domestic regional markets [ph] will rebound first, as it happened in the past as you mentioned. In the airlines, we look for more versatile, flexible and more economical fleet, and we do believe that our E-Jets are very well positioned in that direction. So that's why we believe we have -- we will have a good chance as soon as the market pickup.

Q - Robert Spingarn {BIO 5996882 <GO>}

Okay. And then my last question is about your inventories either in Commercial -- actually in any of the segments, but do you have whitetails in inventory, and if so can you quantify?

A - Antonio Garcia {BIO 21338149 <GO>}

With regards to today's current situation, we have really a few, we are sold out in the small jets in the Executive Aviation, and in the mid-sized jets, we still have three or four to be sold this quarter, again minimal, and also for the Commercial Aviation, we have no while tails for this time being. We do have only the carryover inventory that we are doing to the postponement of deliveries to 2021, but it's not a big amount.

What you do see in our inventory, we are going to run more or less 40% of our revenue in the fourth quarter, which means we are going to -- strongly go down for inventory [ph] in Q4 due to the higher deliveries in Q4. But again no big white tails on the inventory.

Q - Robert Spingarn {BIO 5996882 <GO>}

Thank you very much.

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A - Eduardo Couto {BIO 18009973 <GO>}

Just some comments Antonio, to complement, it's Edu here. So as you said, we basically have no positions available, that's the reason we are so confident on the fourth quarter and on the recover towards the year-end.

Q - Robert Spingarn {BIO 5996882 <GO>}

Okay, thank you all. Thank you.

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

Welcome.

A - Antonio Garcia {BIO 21338149 <GO>}

Welcome.

Operator

Our next question comes from Myles Walton, UBS.

Q - Myles Walton {BIO 6802513 <GO>}

Thanks, good morning. Maybe Antonio on the cash performance here in the third quarter you laid out some of the one-time items. But I think the commentary last quarter was, you could have been closer to breakeven even for free cash flow here in the third quarter. So I'm just curious what changed -- what has pushed out to the right, and I guess, following on Rob's question why couldn't those continue to push out to the right realizing you haven't had any cancellations, but it seems like deferrals are more likely than not?

A - Antonio Garcia {BIO 21338149 <GO>}

Yeah. We -- Myles thanks for the question, again, we -- in the previous calls, we mentioned that we are seeing and we see good chance to become, I would say free cash flow breakeven in the second semester or second half of the year and we are still continue to believe. As you could see we have cash burn in Q3 from \$567 million, and we had skipped some aircraft deliveries to Q4. We have also the severance payments that we had the impact in Q3, we will be much less in Q4 and we have the huge amount of deliveries in Q4. We are still confident and we are seeing progressing the improvement of our free cash flow and also cash collection plays a role and also the other measures that we are taking.

I'd say we are still confident that we will be closer to breakeven in the second semester, but again, if you ask about my expectations, the third quarter we could be -- we could have been better \$250 million. But again have this one-time effects shifting does effect for Q4.

Q - Myles Walton {BIO 6802513 <GO>}

Okay.

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A - Eduardo Couto {BIO 18009973 <GO>}

Just one point-- Myles sorry, it's Edu here. We had some planes that really skipped to the fourth quarter, but as Antonio highlighted in the call, we are already delivered more planes in October than the whole third quarter. So I think that shows that we are very confident on to revert that now in the fourth quarter. And I would say all the deliveries for fourth quarter are confirmed, so we are not seeing risks or delays as we had -- we had some planes that moved from third -- from Q3 to Q4, but now they are all confirmed. Okay?

A - Antonio Garcia {BIO 21338149 <GO>}

Maybe an additional information Myles the Super Tucanos we delivered in September and we delivered but we are going to book as a revenue and cash now in Q4 which also helps in this equation around \$80 million, that is not part of the Q3 results. Again, many issues [ph] working -- happened in Q3, but we should see the rebound in Q4.

Q - Myles Walton {BIO 6802513 <GO>}

Okay. And, Francisco maybe I can ask you as you're repositioning the business and you want to get obviously, the Commercial business in particular to profit or cash breakeven at worst. What is the size? What's the deliveries or the size of the Commercial business that you're sizing the cost structure to and the workforce to?

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

Good question, Myles. We are -- we have been discussing this a lot in our plan for the former years. I mean, we still see 2021 as a very challenging year. I mean -- I would say it's not much higher than we see in this year, but we are working in various fronts in order to adjust the cost structure of the Company to deliver a much better performance in 2021 even which is not much higher than 2020. So and the main reason for that is the Commercial Aviation. We see that the 2021 will be still a challenging year for Commercial Aviation, we are preparing for that scenario but we see an opportunity to grow, I mean, from 2022 onwards.

Q - Myles Walton {BIO 6802513 <GO>}

Do you think 2021 could be breakeven for Commercial Aviation?

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

No. Commercial Aviation will still suffer in 2021, but we can -- the order units will have a much better performance next year.

A - Antonio Garcia {BIO 21338149 <GO>}

And we are seeing this fiscal year. By the way, we are seeing this year not the -- because of -- Myles, we have the -- we are lucky to have a broader portfolio. And we are seeing a good performance in regards to margin for the Executives and Defense & Security and services, which is more or less trying to compensate the drop in the Commercial Aviation with regards to margins and results, but you are going to see the same picture in 2021.

Q - Myles Walton {BIO 6802513 <GO>}

Okay. Thanks again.

A - Antonio Garcia {BIO 21338149 <GO>}

Okay.

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

Welcome

Operator

Our next question comes from Ron Epstein, Bank of America.

Q - Mariana Perez Mora {BIO 16856823 <GO>}

Good morning, everyone. This Mariana Perez Mora for Ron today.

A - Eduardo Couto {BIO 18009973 <GO>}

Hi.

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

Hi.

Q - Mariana Perez Mora {BIO 16856823 <GO>}

My first question will be, could you please give us some color on the short-term customer finance cash headwinds you have this quarter and not only the color on the quarter, but also how and why are you confident that this is going to recover going into next year -- into next quarter?

A - Antonio Garcia {BIO 21338149 <GO>}

Yeah. That was really a short-term timing delay. So we don't do customer finance and we had a very short term finance that we are transferring to the final finance agent. And so there is no risk of not reverting that. So we don't do customer finance.

Q - Mariana Perez Mora {BIO 16856823 <GO>}

Okay.

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

And it's already confirmed that -- it's already confirmed for the ECA in Brazil (inaudible).

Q - Mariana Perez Mora {BIO 16856823 <GO>}

Okay. And then in general, because I understand for competitive reasons you cannot give like particular details but, how is cash profitability compared to like pre-pandemic cash profitability upon delivery?

A - Antonio Garcia {BIO 21338149 <GO>}

Are you talking about the commercial or the whole business?

Q - Mariana Perez Mora {BIO 16856823 <GO>}

Commercial, particularly.

A - Antonio Garcia {BIO 21338149 <GO>}

We are improving, right. We suffer with the lower deliveries, especially in the first half. Third quarter already started to show improvement. But the big improvement will come now in the fourth quarter. As we mentioned, October already better than the whole third quarter and we're going to have much more deliveries and that will drive a big improvement in cash profitability coming from working capital reduction and also the cost adjustments that we did that Francisco and Antonio highlighted.

Q - Mariana Perez Mora {BIO 16856823 <GO>}

Thank you. And if I may the last one, you highlighted improvement and boosted [ph] operations. Have you seen sound like pickup in demand already?

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

Well, you mean demand for 2021 or for the former years?

Q - Mariana Perez Mora {BIO 16856823 <GO>}

Yes, how are your sales campaigns coming in. If you have seen any pickup from - for like business jet demand, what's book to bill there?

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

Okay. Well, I mean Executive aviation is showing a good reaction. We are for example, in our Phenom family, we are sold out for 2020, we are selling aircraft for 2021, the Phenoms. I mean -- so it's moving well. The Defense & Security, we are working in different campaigns as well and also in the Commercial Aviation, we are working in different campaigns, so hope now this second wave of COVID will not bring a negative impact, on the opposite, if they announced a new vaccine, this will help a lot. I mean the rebound of the regional and domestic flights that will help us to boost our sales in the Commercial Aviation as well.

Q - Mariana Perez Mora {BIO 16856823 <GO>}

Okay. Thank you very much.

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

You're welcome.

A - Eduardo Couto {BIO 18009973 <GO>}

Thank you.

Operator

Our next question comes from Cai von Rumohr, Cowen.

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

Thank you very much. So maybe you could comment on the mix of your bizjets. You've done very well -- very well with the 300 and the 100, and basically very, very poorly in terms of deliveries of the legacies and the Praetors. Why you have that sort of extreme mix and should we expect a big pick up in those larger planes in the fourth quarter and going into next year?

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

Cai, thanks for the question. I mean, let's see if I understand your question. But yes, the Phenom 300 is our best-seller, I mean, it's the most sold aircraft in its category for the past 80 years, I would say. I mean but we are improving our sales for the Praetors, the 600 and also the 500 and we have specific programs, specific initiatives in our strategic plan '21-'25 to improve the competitiveness of the Phenom 100 and the Praetor 500. And with those plans, we expect to capture additional market share in the former years for all the family, because we do believe we have a great family with the two Phenoms 100 and 300 and the two Praetors, the 500 and 600.

A - Eduardo Couto {BIO 18009973 <GO>}

And just to add, Francisco now on the -- we had only two Praetors in the third quarter, right, and 19 Phenoms. So we expect a much better performance in terms of the Praetors now for the fourth quarter.

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

Correct. Thank you, Edu.

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

Got it. That was essentially the question. And then going forward, because if we look at this year and last year, basically the third quarter very weak for -- generally weak for the larger bizjets. Do you expect a more level even spread of the large bizjets because the Phenom is clearly doing well, but the large ones where the product looks attractive doesn't seem to be doing quite as well.

A - Eduardo Couto {BIO 18009973 <GO>}

Operator? Can you hear us Cai? Yes. Perfectly. I don't know what that was? Yes, there was some background noise. Sorry.

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A - Antonio Garcia {BIO 21338149 <GO>}

Edu, just allow me to answer. Cai, It's is a good question for sure. We -- if you see the chart I showed, the midsize jets, they are not doing well compared with the small jets, that's why we are sold out in the -- they see now 100, 300, and we still have some open position for the last quarter. But I'd say we do have campaigns for all of them, we start going to service them in other quarter, but I'd say we have talked about five to six aircrafts on the Praetors and with the others, we are sold out and you saw the deliveries we have Year-to-date 43 and we are seeing for the whole year mid-80s for the total of 2020 is actually deliveries, which shows that last quarter will be hard anyway for us, but for sure the, midsize jets, they are suffering more and also the large jets compared with the small jets.

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

Great. And the last question is your gross margins have come down, what should we think about where your gross margins -- what is the incremental gross margin we should think obviously you have different businesses, but overall, if commercial and bizjet get better, what kind of incremental margins should they yield? Thank you.

A - Antonio Garcia {BIO 21338149 <GO>}

It's [ph] my point of view, normalized basis, because we do not have the better mix until now for the fiscal year. I do see (inaudible) for sales in the long run, 15% to 16%[ph]. I would think for the first year [ph].

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

And also Cai, we have a lot of initiatives to help us to reduce the cost of goods sold of the aircraft as well to reduce the production cycles of the aircraft and this will also help us besides the mix that Antonio mentioned, it will also help us to increase the gross margin of our products.

A - Antonio Garcia {BIO 21338149 <GO>}

Yeah. And one important point, we were impacted by the idleness this year in our gross margin, which the adjustment we are doing in our workforce, and not going to happen next year, even the Q4. September was already. If you ask me today. September was already positive in cash flow, just in the month of September, because the idleness is being reduced and should be -- come to end in Q4, which is highly impact our gross margin this fiscal year.

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

Very helpful. Thanks so much.

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

Very welcome, Cai.

Operator

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Our next question comes from Noah Poponak, Goldman Sachs.

Q - Noah Poponak {BIO 16071528 <GO>}

Hey. Good morning, everyone.

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

Hello, Noah.

A - Eduardo Couto {BIO 18009973 <GO>}

Hi Noah.

Q - Noah Poponak {BIO 16071528 <GO>}

In Commercial Aviation, you've mentioned that you haven't really had many cancellations, but if -- there's clearly been a decent amount of deferral activity with the lower deliveries, can you speak to where are your customers deferring to? It sounds like you're saying 2021 deliveries will be somewhere in the zone of similar to 2020, are they deferring to 2022? Or are they deferring even further and are they giving you new plans that you feel are relatively firm? Or are they just still kind of throwing their hands up in the year end and are still very uncertain as to when they're going to want the airplanes?

A - Antonio Garcia {BIO 21338149 <GO>}

Thanks for the question, Noah. The majority of the deferral was between 2020 -- from 2022 onwards, especially the local airline in Brazil (inaudible) Azul, which is impacting us heavily here. And we do see as Francisco mentioned 2021 more or less in the same level of this year. And speaking up, starting 2022 to I would say mid-70s and again they have highest amount of deferral starting 2022 -- '22' and '24. And again, there is no additional postponements or deferrals. We may see -- maybe that's -- if the environment change, the second wave of COVID not going to impact, we may see even customers have to [ph] anticipate something, but today, it's quite stable, everything we discussed between March and April remains the same. Also the deliveries of this year, everything we discussed which was agreed between March and April, and since then, there is no change. Very stable.

A - Eduardo Couto {BIO 18009973 <GO>}

If I may just add Antonio, it's Edu here. Noah, it's important to say that the situation is very fluid, right, given everything going on with COVID, but at a first moment, maybe some customers they put a big deferral, but as the situation starts to get better, they start to operate again, where they're whole time talking to the customers and discussing when exactly they are going to take the plane. So as Antonio mentioned, there could be anticipations, right, to the initial deferral that they put. So the situation could really change depending on how COVID goes especially next year?

A - Antonio Garcia {BIO 21338149 <GO>}

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But again, just to allow me to complete. We are set the company for this new normal, I would say in a lower base in order that we are able to capture more when you get an improvement and the recovering volumes. We are not running the Company by hope is really sit on the ground and be conservative in the volumes for next year.

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

Yeah. And Noah, I mean, just also helping my colleagues here. I mean this year, we had to face a combination of two bad things, right, we had the drop in our revenues because of the COVID impact, but combining that which caused much higher than the normal because of the carve-out of the Commercial Aviation. But we have done our homework, we have adjusted the workforce and we have put in place a of initiatives to reduce costs, to reduce inventories that will help us to deliver a much better financial performance in 2021 even I'd say is not much higher than 2020.

Q - Noah Poponak {BIO 16071528 <GO>}

Okay, great. That's -- I appreciate all the detail on Commercial. Maybe kind of same question on Executive. I mean, obviously, it's fluid, it can change, but for now, would you speak to where you're planning production levels for total Executive units 2021-2022?

A - Antonio Garcia {BIO 21338149 <GO>}

See for the 2021-2022, we are still evaluating the scenarios, we even changed our S&OP process last month and we do see something around 90 aircrafts. But again, still fluid, but you see more or less a good level of 90 aircrafts.

Q - Noah Poponak {BIO 16071528 <GO>}

Okay. And then just last one on Defense. The quarterly revenues have been very volatile. I know you had the delivery restrictions, but it seems like it's been volatile even excluding that, when does the Defense business, I guess just get back on to a more smooth trajectory quarter over quarter? And maybe just kind of walk us back through some of the bigger programmatic moving pieces that can drive growth or not in that segment on a multi-year basis?

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

So, well, I mean -- go ahead Antonio, go ahead.

A - Antonio Garcia {BIO 21338149 <GO>}

No. It's -- the -- For sure, there's always a definitive range [ph] hanging also in the budget of each government that's buying aircraft forever, then the COVID do have some restriction. But I would say what we are seeing in Defense, we are -- somewhere stable on the Super Tucano deliveries and also on the KC-390 volumes that we are operating for this year and also for next year. What you're still missing is additional sales for the C-390 Millenium that we are right now discussing some additional companies. But if you ask me what could boost the situation, it's really additional sales campaigns for this C-390.

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Q - Noah Poponak {BIO 16071528 <GO>}

Should we be thinking about Defense revenues, three to five years out as meaningfully higher or something relatively similar to the current level?

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

No, absolutely higher. We have a good perspective in Defense for years. We are working campaigns for the C-390 Millenium as Antonio mentioned. We also have a business with the Brazilian Navy, Brazilian Army. We have announced an acquisition of cybersecurity company, Tempest. We see opportunities in that field as well. So we have a good perspective for the Defense for the following five years.

Q - Noah Poponak {BIO 16071528 <GO>}

Okay. Thanks so much.

A - Antonio Garcia {BIO 21338149 <GO>}

Welcome.

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

You're welcome, Noah.

Operator

Our next question comes from Augusto Ensiki, HSBC.

Q - Augusto Ensiki {BIO 15988025 <GO>}

Hi, good morning. Just a quick question, (inaudible) in your financials that your financial -- your financial expense increased sharply, is that related to the paydown of the some of the -- some of your debt as well as the issuance of the new debt? And what would be a more normal level if not the one this quarter? Thank you.

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

Yeah. Thanks, Augusto. Yes, you're right, there are some additional costs related to the new debt that we raised in the third quarter. We also had some impacts from basically non-cash FX losses, which is non-cash and we also had an RVG provision. So that affected our financial expenses.

I would say the normal level would be more something around \$50 million per quarter, that would be our net financial expenses per quarter,

A - Antonio Garcia {BIO 21338149 <GO>}

Included in the new debt. (multiple speakers)

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Q - Augusto Ensiki {BIO 15988025 <GO>}

Okay. Thank you very much.

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

Okay.

Q - Augusto Ensiki {BIO 15988025 <GO>}

Thank you.

Operator

Our next question comes from Paul (inaudible) Loomis Sayles. Please proceed.

Q - Unidentified Participant

Hi, thanks for taking the call and taking the question. There's [ph] a loan maturity in the fourth quarter, I'm curious how you are planning on handling that?

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

Sorry, what was the question?

Q - Unidentified Participant

Is the loan maturity in the fourth quarter, I'm just curious how -- what are the plans to handle that?

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

Yeah, as I, as I mentioned, basically, now we had a very short-term customer finance that was already solved and transferred to the finance agent. So there is no -- it's nothing material. Okay? It had an impact when you look the picture of the end of the quarter, but it was already sold.

Q - Unidentified Participant

So there is no \$600 million maturity in the fourth quarter?

A - Antonio Garcia {BIO 21338149 <GO>}

No,

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

No. We have in the fourth quarter is -- it's around \$100 million, \$150 million.

Q - Unidentified Participant

Okay. Thank you.

Operator

Thank you. 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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