

Q1 2022 Earnings Call

Company Participants

- Antonio Garcia, Executive Vice President, Financial and Investor Relations
- Francisco Gomes Neto, President and Chief Executive Officer

Other Participants

- Josh Milberg, Analyst
- Louis Raffetto, Analyst
- Lucas Barbosa, Analyst
- Mariana Perez Mora, Analyst
- Noah Poponak, Analyst
- Stephen Trent, Analyst

Presentation

Operator

Good morning, ladies and gentlemen, and welcome to the audio Conference Call from Embraer First Quarter 2022 Financial 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 believe, may, will, estimates, continues, anticipates, intends, expect 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 are discussed on this conference call might not occur. The Company's actual results could differ substantially from those anticipated in the forward-looking statements.

It is important to mention that all numbers are presented in US dollars as it's our functional currency. 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. Leonardo Shinohara, Director of Investor Relations.

I would now like to turn the conference over to Mr. Gomes Neto, who will proceed the first remarks of our first quarter 2022. Please go ahead, sir.

Francisco Gomes Neto {BIO 19328044 <GO>}

Good morning and thank you all for joining our first quarter 2022 results call today. I hope that all of you are well and safe, and I thank you for your interest in our Company. The first quarter results continue to show that our planned execution in Company turnaround remains underway and our focus to drive innovation and enterprise efficiency are key pillars to our growth strategy. As you will see later in Antonio's presentation, we are maintaining our guidance for the year and our numbers show that even with a shutdown of our operations during the month of January, to integrate the Commercial Aviation Systems, we were able to deliver solid results.

Before we go into more financial details on the first quarter, I would like to give you some quick highlights of our key actions. First on innovation. Eve's closing is expected in May. The listing at the New York Stock Exchange will accelerate in bringing innovation to the new Urban Air Mobility ecosystem. Speaking about our innovation pipeline, we have several ongoing projects such as Zero or low carbon emission in airframe efficiency. Second, enterprise efficiency. We continue to work with great focus and discipline on improving efficiency in all business units, in our administrative areas and operations, applying lean principles and continuous improvement culture to several processes. Our financial performance continues to trend up with the best free cash flow in the first quarter since 2010. As mentioned previously, we are maintaining our guidance for the year even with a challenging supply chain due to the war in Ukraine and shortages of products worldwide.

On the next Slide, we will talk about growth and see more details of business units highlights in the quarter. In Commercial Aviation, we have several ongoing campaigns mainly due to steadily rebound of domestic flights in the USA and Europe. The oil price increase also reinforces the relevance of the E2 family as the most efficient narrow body in fuel consumption. Executive Aviation keeps up the good momentum, with sales orders exceeding prior year levels and backlog increase above 12% in Q1 '22 versus Q4 '21. On Defense, we have seen an increased interest in C-390 Millennium and the A29 the Super Tucano from several conference recently. We expect an acceleration in sales campaigns for these products. Services & Support has grown above pre-pandemic levels, with a growing backlog and positive gross margin versus last year. Deliveries of aircraft in the first quarter were slightly below expectations mainly due to approximately 30-day shutdown, which I have committed earlier on.

I will now hand it over to Antonio to give further details on the financial results and I will return in the end. Thank you.

Antonio Garcia {BIO 21338149 <GO>}

Thanks Francisco and good morning, everyone. Let's give some highlights of the first quarter 2022 financial results. By the way, acquired through 60 days activity for the first quarter. Let's get started in Slide 5. First of all, we are reaffirming all aspects of our 2022

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financial and delivery guidance, with no much leverage. Embraer delivered 14 jets in the first quarter, of which six Commercial aircrafts and eight Executive Jets, six light jets and two mid-size jets, all of this according to our schedule. Deliveries in the quarter were negatively impacted by almost one month shutdown in January 2022 due to the Commercial Aviation system and legal reintegration.

True order backlog ended the first quarter 2022 at \$17.3 billion, plus \$300 million versus Q4 2021. This is the highest quarter backlog since second quarter 2018 driven by solid sales activity. On the revenue side, revenue reached \$601 million in the quarter, down 26% compared to the first quarter '21, with almost one month production shutdown in January. In contrast, reported consolidated gross margin of 20% was higher than the 9.5% reported in the first quarter of 2021, due to the better performance in all business units.

On Slide 6, adjusted EBIT and EBITDA. Even with less 26% revenue and higher SG&A compared to the first quarter of 2021, adjusted EBIT and EBITDA margin were \$27 million negative and \$13.2 million positive respectively, yielding adjusted EBIT margin of minus 4.5% and adjusted EBITDA margin of positive 2.2%. Adjusted EBIT Q1 2022 also includes no recurring expenses like Commercial Aviation integration process, arbitration process and others of \$17 million. If we exclude all of the extraordinary effect, adjusted EBIT margin would have been minus 1.7% or minus \$10 million and EBITDA margin of 5% or \$30 million positive. Complementing our strategy to mitigate the exchange risks through the cash flow hedging, we recognized credit of \$800,000 related to payroll expenses in the first quarter 2022. At least, we do see a limited FX impact for this fiscal year in our results between Brazilian reals and US dollar basis.

Moving to Slide 7, let's start with SG&A. SG&A as a whole continues to trend favorably over the past years. Quarterly SG&A reached \$95 million or increase of \$15 million compared to the first quarter '21 figures, due to more activity on the sales side, campaigns impacting expenses, as well the uptick corporate administrative expenses driven by inflation. It's important to say that we remain highly focused on SG&A efficiency. On investments in Q1 2022, Embraer invested a total of \$39 million in product development and research mainly related to G2 commercial jet program, and \$9 million CapEx. It's important to mention, we continue to invest our future with highly disciplined CapEx allocation.

Another good news. Let's go to Slide number 8, starting with adjusted free cash flow. In regards to free cash flow, the Company continue highly focus to improve the cash consuming process. Free cash flow in the first quarter 2022 was a usage of \$68 million, representing a significant improvement compared to the \$227 million negative million in the first quarter of 2021, consistent with working optimization measures and enterprise efficiency. Working capital had a positive impact in the Company over our cash performance, even considering the seasonality of the business, delivering its best first quarter cash since 2010. The main highlights were optimizing inventory management and higher advanced payments from customers compared with the first quarter of 2021.

On the adjusted net results, was a loss of \$79 million. Although negative, we do see net results trending up, driven by revenue growth in the next quarters, fixed cost leverage, reduction interest cost due to our liability management activities and the full tax efficiency

that we get back from the legal reintegration of Commercial Aviation. All of these effects together will provide an additional positive impact earnings for this fiscal year.

So let's move to Slide number 9, liquidity. The Company finished the quarter with a total debt of \$3.5 billion or \$500 million less than Q4 2021, in line with our strategy and net debt of \$1.5 billion. Embraer continues to de-lever the balance sheet, reducing systematically the gross debt and improve the credit metrics and we do expect to reduce the interest expenses with that. It's important to highlight that our net debt to EBITDA ratio is around 3.7 times in first quarter of 2022 and we really remain focused on generating cash and reducing our debt levels.

With that, I conclude my presentation and hand over back to Francisco for his final remarks. Thank you very much.

Francisco Gomes Neto {BIO 19328044 <GO>}

Thanks, Antonio. At close, I'd like to briefly highlight our Urban Air Mobility, Eve. The listing at the New York Stock Exchange and closing is expected for the next month in May, with total investments of about \$500 million, which includes SPAC and strategic investments. Eve has the strategic support from Embraer with access to infrastructure, extensive aircraft certification and manufacturing experience and already established global network of services and support, intellectual property and engineers as major differentiators from other projects.

Finally, we have strategic partners such as SkyWest, Republic Airways, BAE Systems, Rolls-Royce, Azorra, ex-China [ph], Falko and Thales who know very well our capabilities. Thank you to our great team for their focus and passion for creating innovation and executing our strategic planning. And thank you for your interest and confidence in our Company.

Questions And Answers

Operator

We will now start the question-and-answer session. (Operator Instructions) Our first question comes from Myles Walton, UBS.

Q - Louis Raffetto {BIO 6504202 <GO>}

Hey, good morning. This is Louis Raffetto on for Myles. Hello?

A - Antonio Garcia {BIO 21338149 <GO>}

Hello.

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

Hello.

Q - Louis Raffetto {BIO 6504202 <GO>}

Can you hear me?

A - Antonio Garcia {BIO 21338149 <GO>}

Yes, we can.

Q - Louis Raffetto {BIO 6504202 <GO>}

All right, great. I just want to check on free cash flow you guys mentioned was the best in over 10 years. How do we think about that the rest of the year? It seems like a very strong start. Is there anything else that you guys see over the next couple of quarters before your seasonally strong fourth quarter?

A - Antonio Garcia {BIO 21338149 <GO>}

Thanks for the questions. Antonio speaking here. Thanks. It's a great present, we have a good start for sure. And that's why when we -- we set the guide and we said \$50 million plus or better and -- but we this year positive attained yes. We don't know the magnitude of how much we are talk about to be better, but we should be more precise in the second quarter. But for sure the trend is highly positive, with a good start.

Q - Louis Raffetto {BIO 6504202 <GO>}

Okay. Great. Thank you. And then the other expense line, obviously there's a lot going on and there you took out the \$9 million of Eve expense, there's another \$17 million in there, how do we think about that line the rest of the year?

A - Antonio Garcia {BIO 21338149 <GO>}

Yes, for the Eve, everything we are showing our numbers, we just have the portion of Embraer and Eve and we hope and we expect and we are going to do it indeed with the listing in the New York Stock Exchange, then the price become a different dynamic in our results, because we are going to -- on the EFER [ph] estimate to capitalize those expenses most part of it. And then we are going also to update our guidance including Eve, which is from one side is going to boost the cash flow, but it's also going to impact a little bit the EBIT side. So as soon as we close the transaction, then we are going to revise also the guide. But we do not see a discontinuation. But we do not have also in our numbers today, Eve embedded only then I mean on that we are seeing as adjusted EBIT with the adjustment because the Company still operates and we are going to revise it in Q2.

Q - Louis Raffetto {BIO 6504202 <GO>}

Okay. And I guess when I think of those non -- those other non-recurring costs, you said that had arbitration as well as the reintegration. So I would guess the reintegration costs go away, and that -- that sort of non-recurring will continue, but at a lower rate than the \$17 million?

A - Antonio Garcia {BIO 21338149 <GO>}

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Yes. Probably yes. We for sure starting Q2 towards a move that much more cost for the re-integration than we still keeping with the arbitration cost that we are not adjusting. We will see the magnitude of the number that should be more or less on this level, a little bit less for the coming quarters. Okay. And please, when you do your math, adjust in your calculations this number. We are not adjusting because of confidentiality, but you have more or less the magnitude and there is in my opinion this \$17 million that we are seeing right now, should be more or less in this range for the coming quarters. We do not see exceed on this cost, may be a little bit reduction.

Q - Louis Raffetto {BIO 6504202 <GO>}

Okay. Great. Thank you.

A - Antonio Garcia {BIO 21338149 <GO>}

Welcome.

Operator

Our next question comes from Mariana Perez Mora, Bank of America.

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

Good morning, everyone.

A - Antonio Garcia {BIO 21338149 <GO>}

Good Morning, Mariana.

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

Can you please discuss how sustainable are these margins on per like segment, how they compare to your targeted margins, like -- like three to five years from now?

A - Antonio Garcia {BIO 21338149 <GO>}

That's, Mariana. We -- I would say the margins you are seeing per segment for sure. We should see in the long term. We are still away from, I would say Executive and Services, we are more or less in the level we do see for the future, but we do have, still have to prove in Defense and Commercial Aviation, to the same level of the others. It's more or less in a -- in a long-term perspective what we are seeing right now, we are in the recovery mode for the Commercial Aviation and we still have something to do in Defense and most probably Defense is going to recover faster because we are going to see significant improvements starting from 2022 onwards. Commercial Aviation got you take a little bit more time in order to the new campaigns start to showing up better. I would say gross margin performance as we have, it is the old quarters. That's more or less in a nutshell where I see right now all business units come to this level in the mid term.

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

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Thank you. Could you please discuss what's the customers' interest, how your conversations are going and how was this demand and then also what are you seeing in the Services side?

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

Could you please repeat your questions? There was some noise in the line and we are not able to understand.

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

Sure. So, on Executive, could you please give us some color on the demand going forward, how your conversations with customers are going on and how sustainable do you think these like, really strong demand for Executive that we are seeing so far?

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

Sure. Well I think the sales, our sales in the Q1 is -- is showing us that the demand continuously strong. We sold 35 aircraft in Q1. I mean the highest -- the highest in the past almost six years, you know, we had only 2016 Q1, we sold 36 aircraft in that quarter. So it's a good sign for us. We, yes, we believe we are going to have some changes in the future, but we believe in a soft landing in the market and we are seeing a lot of first-time buyers in the segment and the -- and the interest in the small and medium size jets, exactly where we have our portfolio of products. So again, we are still confident that this market will continue to be strong during the next two or three years at least.

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

Thank you. And then last one from me on Defense, you mentioned foreign interest and strong international interest. Could you please give us some color on like or try to quantify that interest?

A - Antonio Garcia {BIO 21338149 <GO>}

Mariana, we do not disclose the volumes, especially in that segment. But what we can see is that, yes, we are having -- we are having a lot of customers, I mean, coming to us and asking for deliveries opportunity in a short and medium term and which was a change that we believe it was because of the -- of the situation in Europe, between Russia and Ukraine. So again good opportunities for us, for our products, you know the C-390 Millennium and the A29 Super Tucano in short and medium term.

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

Thank you very much.

A - Antonio Garcia {BIO 21338149 <GO>}

Thank you, Mariana.

Operator

Our next question comes from Lucas Barbosa, Santander.

Q - Lucas Barbosa {BIO 20835372 <GO>}

Good morning, Francisco. Good morning, Antonio. Thanks very much for the opportunity. I have actually a follow-up from the question on Defense side, and actually adding to that discussion on Commercial Aviation as well. You mentioned in the presentation that in Commercial Aviation, you have some key active campaigns in progress. Then also you mentioned in the presentation the increased interest for the C-390 and for the Super Tucano. Could you just comment a little bit of when you would expect new orders to come out? So would you expect more orders to be announced over the second half of this year or is it something that maybe will take place in 2023? So, any color you could give on the timing that you would expect new orders to come out, that would be very helpful. Thank you very much.

A - Antonio Garcia {BIO 21338149 <GO>}

Thank you, Lucas. Well for the Commercial Aviation, we expect new orders due this year and in the Defense, a mix between 2022 and 2023.

Q - Lucas Barbosa {BIO 20835372 <GO>}

Perfect. Thank you very much.

A - Antonio Garcia {BIO 21338149 <GO>}

You are welcome, Lucas.

Operator

Our next question comes from Stephen Trent, Citi.

Q - Stephen Trent {BIO 5581382 <GO>}

Thank you everybody and good morning and thank you for taking my question. When I think about the order activity or the order potential on the Commercial Aviation side, do you have any high level view with respect to where we could see the order activity come from a geographic perspective? Are you guys seeing anything in for example, the potential Scope clause adjustment in the US or are you seeing maybe somewhat better order potential coming from emerging markets? Thank you.

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

Thanks for the question. Well, specifically the Commercial Aviation, we -- I mentioned that we are working in several sales campaigns, that we believe are because of the domestic air travel recovery and also some decisions on future renewal to new generation aircraft, especially where our product, our E2 family is well positioned, because of the efficiency compared to the older aircraft. Also we launched a project to convert the passenger jets into freighters, that we believe we will -- there needs to explore a good opportunity as the global air cargo is growing, you know, up to 12% year versus year versus 2019. So, and

then there is a strong demand for E-jets freighters as the market you know, wants now to do receive the goods I mean, in the next day or even the same day, so that we see a good opportunity for our E-jets freighters. And last, I mean there is good progress, we don't see any changes in the short term, in the next, I don't know, at least the five to six years. So, which is a good opportunity for us to continually selling our E1 family, E175 E1s.

Q - Stephen Trent {BIO 5581382 <GO>}

Okay. Very helpful. I missed the first two or three minutes of your call, so sorry if that was a repeat of what you said earlier. But, thanks very much.

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

You're welcome.

Operator

Our next question comes from Noah Poponak, Goldman Sachs.

Q - Noah Poponak {BIO 16071528 <GO>}

Hi, good morning everyone.

A - Antonio Garcia {BIO 21338149 <GO>}

Hello, Noah.

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

Hi, Noah.

Q - Noah Poponak {BIO 16071528 <GO>}

Hi. What's your expectation for book-to-bill for the year at Commercial?

A - Antonio Garcia {BIO 21338149 <GO>}

Our strict vision is to keep the same level we saw last year of two to one.

Q - Noah Poponak {BIO 16071528 <GO>}

Okay. Good to know. What is in the full year revenue guidance for the Defense segment at this point?

A - Antonio Garcia {BIO 21338149 <GO>}

Noah (technical difficulty) We do have for Defense around \$600 million. It's pretty weak this year for Defense.

Q - Noah Poponak {BIO 16071528 <GO>}

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Okay. And then, I guess maybe could you speak a little bit to you know, your thinking on the medium to long-term growth rate in that business from here? I mean it's been quite choppy for a while from this lower level of revenue. What's your -- how are you seeing that play out?

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

Well Noah, Francisco speaking now. Yes, we see a tough year this year for Defense as Antonio said. So we are working on several initiatives to improve the performance of that unit already in 2023 and the new -- the new market environment will help us a lot, not only in 2023, but in the years ahead with -- with the high -- with this highest -- with the highest interest in the -- in the C-390 Millennium. That is -- is a product with a very high value added. So we expect it to reach soon to be back to \$1 billion in revenues in our Defense unit.

Q - Noah Poponak {BIO 16071528 <GO>}

Okay. Great. And then on the -- on free cash, can you maybe just speak a little bit to the, your expectation of the sequencing through the year, just given the working capital in the first quarter -- the working capital change in first quarter was different than it's been in the first quarter for a while here. So the -- it sounds like the shape of the year is fairly different than it's been?

A - Antonio Garcia {BIO 21338149 <GO>}

By the way, thanks for the questions. Antonio speaking. And thanks also for recognize our efforts, as I try to speak to the market. We are growing revenue but we are improving the working capital at the same time and the trends is to become positive in the quarters to come. We do not have a spike in the negative side to go again. We have the cash steering process we control in a daily basis, that's why we are quite confident that the quarters to come, it will be positive and to a point that to probably we are going to revise our cash guidance in Q2. Because we said \$50 million better, now we are evaluating how better we could do.

Q - Noah Poponak {BIO 16071528 <GO>}

Okay. Excellent. Okay. Great. Thanks so much. I appreciate it.

A - Antonio Garcia {BIO 21338149 <GO>}

Thank you.

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

Thank you.

Operator

Our next question comes from Myles Walton, UBS.

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Q - Louis Raffetto {BIO 6504202 <GO>}

Hey. Thanks for the follow-up. Just wanted to go back to, I think to Mariana's question on the gross margin. So I know, two years ago when you separated out Commercial, your gross margins jumped that quarter because of how you were accounting for, I think pay, is that sort of going on again this first quarter, is that driving any of the gross margin increase?

A - Antonio Garcia {BIO 21338149 <GO>}

Yes, we do have an impact around 2% and because of the obsolescence in January in that account.

Q - Louis Raffetto {BIO 6504202 <GO>}

Okay. So that is --

A - Antonio Garcia {BIO 21338149 <GO>}

But -- but we do believe we could stay in this level for the quarters to come.

Q - Louis Raffetto {BIO 6504202 <GO>}

Okay. Thank you.

Operator

Our next question comes from Josh Milberg, Morgan Stanley.

Q - Josh Milberg {BIO 19336060 <GO>}

Good morning, everyone. Thank you for the question. I just wanted to ask if you are --

A - Antonio Garcia {BIO 21338149 <GO>}

Good Morning, Josh.

Q - Josh Milberg {BIO 19336060 <GO>}

How are you? Just wanted to ask if you could update us on the turboprop project (ends abruptly)

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