

Q1 2019 Earnings Call

Company Participants

- Eduardo Couto, Director of Investor Relations
- Nelson Salgado, Executive Vice President, Finance and Investor Relations

Other Participants

- Analyst
- Augusto Ensiki
- Cai von Rumohr
- Caitlin Dullanty
- George Ferguson
- Turan Quettawala
- Victor Mizusaki

Presentation

Operator

Good morning, ladies and gentlemen, and welcome to the audio conference call that will review Embraer's First Quarter 2019 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.

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Participants on today's conference call are Mr.Nelson Salgado, Executive Vice President Finance and Investor Relations; and Mr.Eduardo Couto, Director of Investor Relations.

I would now like to turn the conference over to Mr.Nelson Salgado. Please go ahead, sir.

Nelson Salgado {BIO 19113798 <GO>}

Good morning, everyone.

We'll start our presentation at Slide 4, talking about business unit highlights first on Commercial Aviation.

We delivered 11 new jets in the first quarter 2019, including the first delivery of 175 jets in Africa to Mauritania Airlines. In terms of new E175 sales, the American Airlines, SkyWest, signed an additional front order for nine 175 jets, reaching an interesting mark of 158 orders since 2013. From this, 147 aircraft have already been delivered to SkyWest.

As far as the E2 program, we had a very important result in the first quarter. Similar to what happened last year, we delivered 90 E2. The E195-E2 was granted triple certification by ANAC, FAA and EASA, the local authority from Brazil, U.S. and Europe with the first delivery of the E195-E2 to Azul Airlines is expected to happen in the first quarter of 2019.

And finally regarding E2 new sales, the Nigerian carrier, Air Peace placed an order for up to 30 E195-E2 jets, and this was our first E2 order in Africa.

Moving to Slide 5, highlights of Executive Aviation. We have delivered 11 executive jets in the first quarter. And important to say, we sold more than \$300 million in new jets during this period. This was our best first quarter results in terms of sales in the last three years.

Embraer was also very proud to deliver the 600th Phenom 300 aircraft, the only business jet to achieve this milestone in the last 10 years. This is a real proof of the huge success of the Phenom program and its ability to deliver superior performance technology and comfort to our customers.

Finally, talking about our most recent launch, we announced in the first quarter that Praetor 600 was granted its type certificate by ANAC, the certification authority from Brazil and thus became the only super-midsize business jets to be certified since 2014. It's very important to say that with the certification and the last flight tests, we are very happy to announce that the Phenom, the Praetor 600 surpassed all main design goals and including a range that goes beyond 4,000 nautical miles being able to make most of flights between London and New York, Sao Paulo and Miami, Dubai and London.

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Customers have already noticed the superior performance of the Phenom 600 -- the Praetor 600. And we're happy to announce that the Praetor is sold out until May 2020 with first delivery referring now in the second quarter of 2019.

Next slide is Slide 6, we move to Defense & Security. The KC-390 program continued its preparation for entry into service with the Brazilian Air Force in 2019. Flight test campaign exceeded 2,000 flight-hours with focus now on the military missions. The aircraft has successfully accomplished two important airdrop -- a series of tests in Brazil and in the U.S. As far as new programs, the Consortium Águas Azuis formed by Thyssenkrupp, Embraer and Atech was chosen as the preferred supplier to use four new ships to the Brazilian Navy.

And finally two A-29 Super Tucano aircraft were delivered to the Light Air Support Program LAS of the U.S. Air Force in the first quarter of 2019.

Moving to Slide 7 with highlights of our Services & Support, we continued to expand the Services & Support business with revenue and profitability growth. In the fourth quarter -- the first quarter of 2019, we added to our pool program, new customers, new E1 operators, including WDL Aviation, Mauritania Airlines and Air Botswana. We have also added new E2 operators to our Services & Support base such as Air Astana from Kazakhstan and Binter Canarias from Spain.

Moving now to the financial results. We'll start in the Slide 9 with few order backlogs that reached \$16 billion at the end of the first quarter. This is slightly down the value at the end of 2018, but significantly above the value that we registered in the first quarter of 2018, which was \$13.6 billion. We reaffirm here the trend of recovery in our backlog.

As far as deliveries in the Slide 10, in Commercial Aviation, we have the first quarter with 11 deliveries versus 14 the same period last year. This does not impact our guidance for the year, which remained 85 to 95 deliveries in 2019. Just as an additional information; in April alone, we delivered nine additional jets.

On executive jets, we had 11 planes delivered in the first quarter, same number of last year with eight small jets and three larger jets. Important to say, we anticipate a stronger biz jet deliveries in the rest of the year, especially with the entering to service of the Praetor 600 that will happen now in June. Here also we reiterate our guidance of 90 to 110 deliveries of executive jets in 2019.

Moving now to Slide 11, which shows our revenues in the period; consolidated revenues declined to \$823 million in the first quarter of 2019, relatively to first quarter 2018. And this reduction was mostly driven by lower commercial jet deliveries. And this is broken by \$281 million in Commercial Aviation; \$117 million in Executive; \$179 million in Defense & Security and \$244 million in Services & Support.

In Slide 12, we present our SG&A expenses, which are very much stable compared to first quarter 2018. We had \$116 million in expenses broken by \$46 million in G&A and \$70 million in selling expenses.

Moving to Slide 13, we present our adjusted EBIT. We reported a negative EBIT of \$15 million, implying a negative 1.8% EBIT margin. This EBIT margin includes the additional separation costs for the carve-out and preparation of conclusion of the transaction with Boeing by the end of the year.

Important to remember that in the first quarter, the results were negatively impacted by lower Commercial Aviation deliveries that we expect to recover in the next quarter. As I already mentioned, in April alone, we delivered nine additional jets. We maintain our guidance of breakeven EBIT for the company in 2019, remembering again that this includes the separation costs associated with the carve-out of our Commercial Aviation group.

Moving to Slide 14; we reported EBITDA of \$31 million with 3.8 EBITDA margin, driven by the similar reasons we already explained in the operating results.

Next slide, Slide 15, we show net income. We reported an adjusted net income, excluding the impact of deferred income tax of minus \$62 million, affected by the weak operating results that are normal in the first quarter.

Slide 16 represents our investments, which amounted to \$102 million broken by \$9 million in research, \$65 million in development and \$28 million in CapEx. Different from last year, in this quarter, we did not receive any contribution from risk-sharing partners.

Next slide, Slide 17, represents our free cash flow. Embraer had a free cash flow consumption of \$665 million in the first quarter of 2019 with \$558 million negative coming from operations, \$43 million addition to power, property and equipment, and \$65 million addition to intangibles. Our free cash flow consumption is generally negative in the first quarter compared to first quarter last year. We had \$445 million negative in spite of around \$67 million of the contribution for risk sharing partners.

In this quarter, the main reason for the growth of the consumption are first the higher inventories that again are normal in the first quarter as we prepare for higher delivery rates in the rest of the year, especially here in Commercial Aviation. And second, by lower payments from the Brazilian government in some of our defense quarters during the conflict. This amounts to around \$100 million, which we did not receive.

Moving to Slide 18, we highlight our indebtedness profile. Again, 92% of our total debt remains in the long-term with an average maturity of 5.3 years. We closed the first quarter with total cash of \$2.48 billion and the total debt of \$3.59 billion, implying a net debt of \$1.1 billion. We announced a guidance for the year that with the closing of the transaction, we intend to pay \$1.6 billion in extraordinary dividends to our shareholders and start life with new Embraer with the \$1 billion net cash position after close. This result there arguably subjected to result that we will have throughout the year, but we feel confident that we will get there. And we will keep you posted on this as next results come.

And finally, moving to Slide 19, our final configurations and further remarks, I would just like to mention that Embraer had announced Francisco Gomes Neto, the former President of Marcopolo as our new CEO and President. And that was effective now in May. Francisco

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brings a long experience from the automotive sector leading an important turnaround at Marcopolo in the last three years. Francisco is now investing in his integration at Embraer visiting our main facilities, clients and suppliers, and he will join us in our next conference call.

Second, just a brief update on the Embraer-Boeing strategic partnership. We currently have ongoing interaction with several antitrust authorities in different jurisdictions throughout the world and we keep working hard on the carve-out project so that we can separate the Commercial Aviation business. We expect the transition to close by the end of 2019; obviously, that depends on our approval being obtained on time.

With that, we conclude our presentation and would like to open for questions.

Questions And Answers

Operator

(Question And Answer)

(Operator Instructions) Our first question comes from Ronald Epstein, Bank of America Merrill Lynch.

Q - Caitlin Dullanty {BIO 20312970 <GO>}

This is Caitlin Dullanty on for Ron Epstein. With respect to the recent 737 MAX issues, has there been a change in Boeing's commitment to the Embraer partnership? Do you see this affecting the timing of the deal close?

A - Nelson Salgado {BIO 19113798 <GO>}

No, there is no relation between this and the strategic partnership between Boeing and Embraer at all.

Q - Caitlin Dullanty {BIO 20312970 <GO>}

Okay. Thank you. And one more if I could, volume was a little light in the quarter, but gross margin was solid. What's driving the better gross margins at these low volumes?

A - Nelson Salgado {BIO 19113798 <GO>}

I did not understand the question, please.

Q - Caitlin Dullanty {BIO 20312970 <GO>}

Revenues were a little light in the quarter, but gross margin was solid and strong in the quarter. Can you talk a little bit about what's driving the better gross margins?

A - Nelson Salgado {BIO 19113798 <GO>}

That was driven by Services and Defense that had good of gross margin in the period.

Q - Caitlin Dullanty {BIO 20312970 <GO>}

Okay. Thank you.

Operator

The next question comes from Cai von Rumohr, Cowen and Company.

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

Yes, thank you very much. So, Nelson, you had very good book-to-bill in your biz jet business. Can you first give us a little bit of color of what products, what geographies are particularly strong? And secondly, given the very strong orders you had, how come the deliveries were as weak as they were?

A - Nelson Salgado {BIO 19113798 <GO>}

Well, thank you, Cai. The market in U.S. remains the most important market for business jet deliveries. We had these 11 deliveries, which are normal for the quarter.

A - Eduardo Couto {BIO 18009973 <GO>}

We're still not delivering the Praetor yet.

A - Nelson Salgado {BIO 19113798 <GO>}

Yeah, and the sales are driven mainly by the Praetor 600, which will only start to be delivered in the -- after June, that's when we will have the first delivery. Obviously, the Phenom 300 remains a strong player, right? And we remain focused on next months, but I'd say that the Praetors are the big driver for the additional sales. And delivery will only start by midyear.

A - Eduardo Couto {BIO 18009973 <GO>}

If I may add, Nelson -- It's Eduardo here, Cai. It's important to say that we are better sold this year on business jets than we were last year at the same time. So, we are confident in our guidance of 90 to 110 deliveries and that is reflected in our amount of sales.

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

Thank you very much. And the last question, commercial aircraft orders, what impact has the expected Boeing JV venture had on demand for the product? Have you seen greater interest as a result of that or maybe a delay until people see that the deal actually goes through? What impact has that had on your commercial orders?

A - Nelson Salgado {BIO 19113798 <GO>}

Look, I think the last part of last year, right, we saw I think the air show. We announced many new orders and deals. The new orders converted into contracts had slowed down

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little bit, but the interest in the market is very high. There were lots of campaigns going on. We cannot say for sure how much of this is really influenced by the announcement of the deal. That is just market dynamics. What we can confirm that there are lots of campaigns going on and a lot of interest in the project.

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

Thank you very much.

Operator

Our next question comes from Augusto Ensiki, HSBC.

Q - Augusto Ensiki {BIO 15988025 <GO>}

Hi. Thanks for taking my questions. Firstly, you mentioned that the Praetor 600 is sold out until May 2020. Could you tell us how many units approximately that represents? And secondly -- and sorry if it's already discussed in the call, the onetime item regarding impairments in the quarter as well as the JV cost, is it possible to quantify how much those were?

A - Nelson Salgado {BIO 19113798 <GO>}

The Praetor 600 deliveries, I think we've had around 15 deliveries, right? And it is going through an increase as we move to the next year, right? As we said, the first open position for delivery is around May next year. Can you repeat the second part of the question, please?

Q - Augusto Ensiki {BIO 15988025 <GO>}

Sure. Thanks for that. The second question was regarding the impairments on the used jet portfolio and the separation costs that you have in the quarter. I wish you could give us exactly a breakup of how much each of those were separately.

A - Nelson Salgado {BIO 19113798 <GO>}

Yeah, we had some regular impairments in the Commercial Aviation aircraft, but nothing different from what we generally register at the end of the year. In Executive Aviation, there is nothing.

A - Eduardo Couto {BIO 18009973 <GO>}

In terms of the separation announcing costs.

A - Nelson Salgado {BIO 19113798 <GO>}

Oh separation costs, we had around \$12 million recorded in separation costs during this quarter.

Q - Augusto Ensiki {BIO 15988025 <GO>}

And sorry, just one follow-up on the separation costs. I think you previously mentioned -- you guided about \$1.2 billion of separation costs including taxes, is that estimate still hold or you said that there might be additional savings on that figure? If you can give us an update. Thank you.

A - Nelson Salgado {BIO 19113798 <GO>}

The estimate still holds, but we are already working very hard to bring that number down, right?

Q - Augusto Ensiki {BIO 15988025 <GO>}

Okay. Thank you, once again.

Operator

Our next question comes from Victor Mizusaki, Bradesco BBI.

Q - Victor Mizusaki {BIO 4087162 <GO>}

Hello. Two questions here; the first one, I don't know if it's possible, but can you give the breakdown of operating margins per business unit in the first quarter? And the second one, I want to take a look on inventories on quarterly basis, we can see an increase. So, I would like to understand how much is coming from Commercial and how much is coming from Executive Aviation?

A - Nelson Salgado {BIO 19113798 <GO>}

Regarding the first part of the question, we are not disclosing EBIT by business, but what we can tell you is that when we look at the results for the business that is being separated, be it Commercial Aviation and related services, that margin was approximately low. And the margin for Executive business and related services was around 3.5 negative. I -- can you repeat the second part of the question?

Q - Victor Mizusaki {BIO 4087162 <GO>}

With regards to inventories, I mean we can say it increased in the first quarter if you compare it to Q4. So, I'd like to have a better sense of how much is related to Commercial Aviation and how much is related to Executive Aviation.

A - Nelson Salgado {BIO 19113798 <GO>}

You're asking about the increase in inventory during the first quarter? Is that your question, Victor?

Q - Victor Mizusaki {BIO 4087162 <GO>}

Yes, yes.

A - Nelson Salgado {BIO 19113798 <GO>}

Yeah. I'll say that around 70% of that is associated to Commercial Aviation, right, and the rest to Executive, which again is normal at this point of the year, right?

Q - Victor Mizusaki {BIO 4087162 <GO>}

Okay. Thank you.

A - Nelson Salgado {BIO 19113798 <GO>}

Thank you.

Operator

The next question comes from Turan Quettawala, Scotiabank.

Q - Turan Quettawala {BIO 6362141 <GO>}

Yes. Hi, good morning and thank you for taking my question. I guess I was wondering you mentioned that the used jet sales were lower in the quarter over last year. Can you just give us some reason as to why that happened this year?

A - Nelson Salgado {BIO 19113798 <GO>}

No, sales in Commercial, I think were lower than the last part of last year, right? We announced contracts for many thing that we had previously announced at the air show, right? And there were not as many announcements during this first quarter in Commercial Aviation. Although as I mentioned, we have lots of campaigns going on. But in the Executive Aviation on the other hand, I think we had our best first quarter in sales for the last 3 years, which is mainly an effect of the Praetor 600 and 500 coming into the market later this year.

Q - Turan Quettawala {BIO 6362141 <GO>}

No, I was talking about the used jet sales that you said were lower in the quarter. Revenue from used jet sales in Executive Aviation.

A - Nelson Salgado {BIO 19113798 <GO>}

We mentioned that in the press release, but it's small amount, so we didn't have that many deliveries in the first quarter. So, we also didn't sell that many used jets, but it's really not important. The important number is the new sales of business jets that were very solid in the first quarter as we mentioned, above \$300 million in new sales.

Q - Turan Quettawala {BIO 6362141 <GO>}

Okay. Fair enough and I guess it's last one here from me. I was a little surprised to see the SkyWest order. You have deliveries that are going this year. Can you give us a sense of how many open spots you have on Commercial Aviation for the year?

A - Nelson Salgado {BIO 19113798 <GO>}

No, for the year, all the positions are affirmed. We have not --

Q - Turan Quettawala {BIO 6362141 <GO>}

Okay. Thank you.

Operator

And our next question comes from George Ferguson, Bloomberg.

Q - George Ferguson {BIO 5297518 <GO>}

Hi, yes. Okay. Can you speak to how much the U.S. scope clause negotiations could be slowing down orders for commercial jets? I know it is underway right now with pilot negotiations and they are trying to change some of that scope clause and I am wondering if that is having an effect on commercial jet sales.

A - Nelson Salgado {BIO 19113798 <GO>}

Well, we have strong demand for our current E175. So, we are not seeing a lot of movement in terms of scope negotiation, but we think is something positive for us, because we have a very dominant product in the segment that has conquered more than 80% of market share in this segment. So, we're not seeing really a lot of movement, but we think this is positive for us.

Q - George Ferguson {BIO 5297518 <GO>}

Thank you.

Operator

The next question comes from Kevly Kono, Aegon.

Q - Analyst

Hi and thank you for the call. I was just wondering if you could clarify how much debt you plan to transfer to the JV and if that includes the existing bonds.

A - Nelson Salgado {BIO 19113798 <GO>}

Yeah, that includes all the bonds basically. We will transfer all the bonds and an increase in the amount in cash.

Q - Analyst

Okay. Thank you.

Operator

The next question comes from Gabriel Kavak, CPN Investments.

Q - Analyst

Good morning, guys. Thank you for taking my question. I was just wondering if you guys could clarify a little bit more about the matter of the new KC-390 being introduced in the United States. Thank you.

A - Nelson Salgado {BIO 19113798 <GO>}

Yeah, I think the important point here is the partnership with Boeing for the KC-390, which is part of the strategic partnership that we hope to close by the end of the year. The JV's main objective is to open up new markets for the KC-390. The industrial footprint of the KC-390 will depend on the customers that acquire the aircraft that will be flown through the JV.

We have a final assembly here in Brazil. If it is not necessary, the aircraft will be delivered regularly from this final assembly. So, the main objective of the partnership is not to assemble aircraft outside of Brazil, it's to sell more aircraft to markets in which we could not sell. If at any point these new sales demand that we have some industrial activity in the U.S., then we will consider and the JV will reconsider how to do that, but again, it's not the main objective of the partnership.

Q - Analyst

Okay. Thank you.

Operator

(Operator Instructions) This concludes today's question-and-answer session. I would like to turn the conference over to Mr. Nelson Salgado for his final remarks.

A - Nelson Salgado {BIO 19113798 <GO>}

Thank you very much for your participation in the conference and the questions. Thank you.

Operator

That does conclude Embraer's audio conference for today. Thank you very much for your participation. Have a good day.

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