Elbit Systems Ltd.
Edited Conference Call Transcript
May 1, 2023

Operator: Welcome to the conference call to discuss Elbit Systems' 2022 annual report.

Thank you all for holding, all participants are at present in a listen-only mode. Following management's formal presentation, instructions will be given for the question-and-answer session. As a reminder, this call is being recorded.

I would now like to turn the call over to Rami Myerson, Elbit Systems' Investor Relations Director. Rami, please go ahead.

Rami Myerson: Thank you, Yoni.

Good day everyone, and welcome to the call today to discuss our 2022 Annual Report that includes disclosure on the new segmental reporting structure. On the call with me today are Butzi Machlis, our President and CEO, Kobi Kagan our CFO and Yossi Gaspar, Senior EVP - Business Management.

Before we begin, I would like to point out that the Safe Harbor Statement in the Company's Annual Report on form 20-F filed on 1 May 2023 also refers to the contents of this conference call.

As we do on our regular quarterly conference calls, we will provide you with both our regular GAAP financial data as well as certain supplemental non-GAAP information. We believe that this non-GAAP information provides additional detail to help understand the performance of the ongoing business. You can find all the detailed GAAP financial data, as well as the non-GAAP information and the reconciliation, in the Annual

Report.

On this call we will only discuss our financial results as of 31 December 2022. We plan to report Q1 2023 results towards the end of May.

We reported our earnings for 2022 on 28 March 2023 in our 2022 annual results press release. There are no changes to the financial information we disclosed in our 2022 Annual Report. However we would like to highlight our segment financial information included in the Annual Report, which we will report going forward.

Butzi will begin with a presentation of Elbit Systems' five segments followed by Kobi who will provide information on the financial results of the segments.

We will then turn the call over to a question and answer session.

With that, I would like now to turn the call over to Butzi.

Butzi - please?

Butzi Machlis: Thank you Rami.

The Annual Report that was filed today includes new information on the segmental reporting structure that Elbit has adopted and plans to disclose going forward. I would like to provide some background on our decision to update our disclosure.

At our investor conference on 28 March we presented the transformation that Elbit is implementing from a company with revenues of around $3.5 billion a few years ago to a company with infrastructure in place to support annual revenues of $6 to $7 billion with improved profitability and cash generation. This follows the strong growth in our backlog to a record level of more than $15 billion, approximately 2.8 times our 2022 revenues.

As part of our regular processes, and the operational transformation that also includes changes to our internal reporting, as well as correspondence with our regulator, we decided to adapt the way we disclose our operations to the market. This is also an opportunity to provide additional transparency to investors and analysts.

Elbit Systems reports segment information in five segments beginning with the year ended December 31, 2022. The 2022 financial information we reported for each segment is compared retrospectively to the financial performance of each segment in 2021 and 2020.

The segments are organized by a combination of the nature of products and services offered, together with one geography-based segment, Elbit Systems of America or ESA, reflecting the way management manages the company. The USA is the largest defense market and we believe this structure is suitable to maximize the significant potential.

The five reportable segments are:

Aerospace which provides products and systems for airborne platforms, unmanned aerial solutions, precision guided munition or PGM sensors, aerostructures, training and simulator systems as well as commercial aviation systems.

C4I and Cyber provides C4ISR systems, data links and radio communication systems and equipment, cyber intelligence, autonomous and homeland security solutions.

ISTAR and EW provides a wide range of electro-optic and laser systems as well as a range of Electronic Warfare and SIGINT systems.

Land provides land-based systems for armored and other military vehicles, artillery and mortar systems, munitions for land, air and sea applications including PGM, armored vehicle and other platforms' survivability and protection systems.

Elbit Systems of America or ESA provides products and systems solutions principally to the U.S. military, foreign military sales, homeland security, medical instrumentation and commercial aviation customers.

Management encourages the segments to cooperate on a range of common projects performed by the Company. It is common for the segments to provide their products to the same customers either through joint projects or by marketing and offering combined and integrated solutions containing a variety of capabilities, products, and technologies of the Company’s portfolio from various businesses or subsidiaries, all tailored to satisfy the customer’s or project’s specific requirements.

Management also remains focused on the consolidated results as an important measure of performance, particularly given the high level of cooperation among the segments.

I will now hand over the call to Kobi to discuss the financial results of each segment for 2022.

Kobi Please

Kobi Kagan: Thank you Butzi,

Hello everyone, and thank you for joining us today.

I would like to reiterate Rami's comments that there are no changes to the consolidated financial results we reported on 28 March in the annual report filed today.

I will start my review with some of the highlights of our consolidated 2022 financial results and will then elaborate on the financial information of each segment.

Our consolidated revenues increased by 4% to $ 5.5 billion million in 2022 from $ 5.3 billion in 2021.

GAAP operating income was $368 million versus $419 million in 2021.

Non-GAAP operating income in 2022 was $357 million or 6.5% of revenues compared with $451 million or 8.5% of revenues in 2021.

As a reminder, GAAP and Non-GAAP operating income in 2022 included expenses of approximately $62 million related to stock price linked compensation plans.

I will now review the financial results of each segment and would note that our segmental disclosure of operational income is provided on a GAAP basis.

Aerospace revenues increased by 9%, to $1.73 billion in 2022 from $1.58 billion in 2021, mainly due to Training and Simulation and UAS sales.

Aerospace operating income in 2022 was $106.8 million and 6.2% of Aerospace segment revenues, compared to $129.2 million and 8.2% of segment revenues in 2021. The $22.4 million decrease in operating income was mainly due to increased employee compensation expenses and negative program mix.

C4I and Cyber revenues increased by 8%, to $678 million in 2022 from $625 million in 2021, mainly due to growth in radio and naval command & control systems sales.

C4I and Cyber operating income in 2022 was $49.0 million and 7.2% of C4I and Cyber segment revenues, compared to $ 44.4 million and 7.1% of segment revenues in 2021. The $4.6 million increase in operating income was mainly due to the increase in revenues partially offset by increased employee compensation expenses.

ISTAR and EW revenues increased by 2%, to $1.05 billion in 2022 from $1,03 billion in 2021, mainly due to armored vehicles, night vision and target acquisition systems sales.

ISTAR and EW operating income in 2022 was $49.1 million and 4.7% of ISTAR and EW segment revenues, compared to $66.0 million and 6.4%

of segment revenues in 2021. The $16.9 million decrease in operating income was mainly due to increased employee compensation expenses and negative program mix.

Land revenues increased 5%, to $1.17 billion in 2022 from $1,12 billion in 2021, mainly due to airborne precision munitions sales.

Land operating income in 2022 was $28.6 million and 2.4% of Land segment revenues, compared to $35.6 million and 3.2% of segment revenues in 2021. The $7.0 million decrease in operating income was mainly due to increased employee compensation expenses.

ESA revenues decreased by 2%, to $1.46 billion in 2022 from $1.49 billion in 2021, mainly due to lower medical instrumentation and military avionics' sales partially offset by growth of night vision sales and one additional quarter of Sparton sales, compared to 2021.

ESA operating income in 2022 was $75.0 million and 5.1% of ESA segment revenues, compared to $124.3 million and 8.3% of segment revenues in 2021. The $49.3 million decrease in operating income was mainly due to the decrease in Covid-19 medical instrumentation sales that peaked in 2021, supply chain disruptions and negative program mix.

Other operating income was $68.9 million 2022 compared to $14.7 million in 2021 and included capital gains related to the sales of buildings and investments by subsidiaries in Israel and the UK as well as a facility evacuation grant received by a subsidiary in Israel.

Going forward, we plan to continue to report revenues and operating income of each segment in our annual report. In our press releases for the first second and third quarter, we will provide revenues by segment, which reflect the way we manage our business. Revenues by segment in our press releases for the first second and third quarter will replace revenues by areas of operation, that were previously provided

The revenue split by geographic regions and areas of operations were also disclosed in our annual report.

The areas of operations are a capability or a platform based classification that cross over the different segments.

An example of this are our EW systems provided to US end customers through our ESA segment, for installation on the US Air National Guard F-16s aircraft.

These are included in the Airborne systems area of operations and they are reported as intersegment sales by the ISTAR and EW segment and as third party sales by the ESA segment.

And with that, we will be happy to take your questions.

Operator: Thank you. Ladies and gentlemen, at this time we will begin the question-and-answer session. If you have a question, please press star-one. If you wish to cancel your request, please press star-two. If you are using speaker equipment, kindly lift the handset before pressing the numbers. Your questions will be polled in the order they are received. Please stand by we poll for your questions.

The first question is from Pete Skibitski of Alembic Global. Please go ahead.

Pete Skibitski: Hi, Good Afternoon, guys.

[Several]: Good afternoon, hi.

Pete Skibitski: Guys, do you expect any cost savings or any revenue synergies from this new alignment? You know, Butzi, maybe you could give us more color on how you think things could change as a result of this.

Butzi Machlis: As you know, Pete, we organized the company in a different structure recently, and just for example, we combined the UAV Division with the

Airborne Division and we combined EW and the Electro Optic activities together, under another division.

And this is part of the transformation we are performing in the company, in order to gain more synergies, to reduce overheads, and to be more effective and proactive to the market.

And, as I said, this is part of the transformation process the company is acting right now in order to reach a revenue level of between 6 to 7 billion dollars in the coming years, and to improve profitability and cash generation.

Pete Skibitski: That's great. Very helpful. And then, you may have touched on this at the beginning, but in terms of the segment heads and their annual incentive compensation, how are you guys incentivizing them? Is it sales growth, margin growth? Anything else? I wasn't sure about that.

Yossi Gaspar: Hi, Pete. This is Yossi. How are you?

Pete Skibitski: Good, how are you?

Yossi Gaspar: Good, thanks. Regarding the incentive program, we have for each individual, starting from the highest level, executive level and down to our program managers and below, defined goals that vary from function to function, that include, for example, cash generation, that include profitability, that include revenues, new business, quality criterias, and so on. Every year we define the major highlights that are important for the company and accordingly we assign for each function, the goals and we measure them of course, quarterly and we compensate them by year end usually, with an advance by midyear.

Pete Skibitski: Okay. Okay, very helpful. Thank you for that.

And just, last one from me, question about the US segment. I think you guys mentioned it was a 5.1% operating margin in 2022, which I would say is below US peers. And I know you guys have built ESA up over, decades, one piece at a time, small pieces, initially to get a foothold.

So my question is, do you guys expect to consider, you know, maybe some portfolio reshaping, maybe some portfolio pruning in the US? Because I imagine there are some big margin differences among the businesses in ESA for you. I imagine there are some lower margin businesses and some much higher margin businesses, and, it strikes me that maybe there's an opportunity there, you know, longer term?

Butzi Machlis: Pete, we see all our activities in the US as core activities. We always adapt here and there and some of the activities. But in general, we see all the activities we have in the US are core to the company. The US is very important, that's the largest market for Elbit today. And we see it as a strategic market for us.

It's true that in 2022, profit was impacted by stock price linked compensation expenses, as well as lower medical instrumentation sales, and by supply chain disruptions, and the increase of electronic components. I also want to remind all of us that we went live with the new ERP system in the US, which was not an easy task as well. But all of it, and of course project mix as usual. So all of it is, most of it is behind us, and I expect our numbers in the US to improve.

Pete Skibitski: Okay, thanks so much for the color, guys. Appreciate it.

Rami Myerson: Thanks, Pete.

Operator: The next question is from Ellen Page of Jefferies. Please go ahead.

Ellen Page: Hi, guys. Good morning

[Several]: Good morning.

Ellen Page: Just following Pete's question on margins. If we look across the segment, you're in kind of the mid to high single-digit range across segments. Where do you see the most opportunity for margin expansion? You used to talk about a 10% total company target long term. Just as we think about margin improvement across the businesses to get there.

Butzi Machlis: I would expect all segments to grow to the neighborhood of 10% or even above that. That's a strategic goal we have placed to the management. And I think that they're all progressing to this direction. And the beauty of Elbit is the wide portfolio we have on one hand, and the geographical spread on the other hand. And the combination of these two creates stability. So altogether, I do think the company will reach the 10% quite soon.

And as we've mentioned in the conference, which was held a month ago, 2022 was a year of transformation. We are investing hundreds of million of dollars, in new facilities in Israel as well as in the US, in Germany, in the UK, in order to convert the backlog to revenues and to profit. We are going to conclude the implementation of new ERP system mid this year. And after that, we will all operate on one ERP, based on one standard system, which will help us to be more effective and more efficient. And we reorganized the company recently, in order to be more relevant to the market, and more effective as well. But this is true for all the segments.

Ellen Page: Okay. And is there any kind of normalized profitability to think about for the Aerospace segment? It looks like it was pretty depressed a couple of years ago, and I just want to understand like in 2020. And I just want to understand where it was, like, in the previous decade.

Kobi Kagan: Ellen, hi, it's Kobi.

In 2020 we had a one-time write-off related to COVID-19, which was around $50 million dollars on that segment. And we disclose it in our annual report. The non-cash items are disclosed by segment. So you can go and you can look and see the numbers are there. In our new disclosure.

Ellen Page: Helpful. Okay. I'll hop back in the queue.

[Several]: Thank you.

Operator: The next question is from Ella Fried of Bank Leumi. Please go ahead.

Ella Fried: Good afternoon from me, and good morning for all the people on the other side. And I would like first, to say that it's very positive for the company and for the market. This sector information is really enlightening.

And I have a question, maybe already partly answered, but still maybe you could add something. I see that most of the sectors that were the weakest this year were about 2% higher, really dramatically higher profit in the previous year, in 2021. So you mentioned lots of factors. But, is it mostly the supply chain across the board, I mean if you should choose one factor that clearly hurt, say, ESA, and Aerospace, and on the ones that we were lagging.

Butzi Machlis: Hi, Ella. Good afternoon.

There are several reason for that. In 2022, we had stock price linked compensation expenses, which affected the 2022 numbers. And if you convert it to percentage, it's about 1.2% of profit, which was hurt by these expenses. On top of that, supply chain disruption and price increases of electronic components also affected us all over the company. So, these two factors are common to the all segments, and they all affected us. And, both of them will be less relevant, or almost non-relevant, in 2023.

I also want to remind you that, as was presented in the conference, we have invested hundreds of millions of dollars in new facilities, in order to support the transformation the company is going through. And this took place in 2021, in a small numbers, in 2022 in big numbers, and it will continue also in 2023 to enable us to convert the new business with the backlog we have into revenues and the profit.

I also want to say that the exchange rate in 2023 is more favorable than in 2022, and we see less pressure in the labor market. So I do not expect to invest as much in bonuses as we invested in 2022.

Ella Fried: Thank you. And I don't know if you are relating to current update, but the same trends that you showed us at the annual report. Are they intact? Are there any changes? I mean, for better onwards that you could mention, if you can mention them.

Butzi Machlis: The answer is very simple, is no. We do not see any effects on our businesses. And we see a lot of potential ahead of us, in Europe as well as in the Far East and in the US, and also here in Israel. So I do not see any impact on Elbit.

Rami Myerson: Ella, we report our results in a few weeks' time, and that's when we will refer to the current environment. This call is only until the end of December 2022.

Ella Fried: Okay, thank you very much. Thank you for this conversation.

[Several]: Thank you.

Operator: If there are any additional questions, please press star-one. If you wish to cancel your request, please press star-two. Please stand by while we poll for more questions.

The next question is from Shahar Carmi of Psagot. Please go ahead.

Shahar Carmi: Hi, thank you for taking my question. Just a quick one for me, please. With regard to ESA. Is the fact that you now present it separately, means that at one point in the future, that subsidiary might go to an IPO? Is it something that you even consider? Thanks.

Butzi Machlis: Hello, Shahar. Good afternoon. It's Butzi. The answer is no. The synergy between all the businesses, all the segments are crucial to the success of the company. And as you can see, there are many transactions between them. So we see Elbit Systems of America as an integrated part of Elbit, and it will continue to be this way. So we do not consider any IPO.

Shahar Carmi: Okay. Thank you.

Rami Myerson: Thanks, Shahar.

Operator: There are no further questions at this time. Before I ask Mr. Machlis to go ahead with his closing statement, I would like to remind participants that a replay of this call will be available two hours after the conference ends. In the US, please call 1-888-782-4291. In Israel, please call 03-925-5900. And internationally, please call 972-3-925-5900. A replay of this call will also be available on the company's website, www.elbitsystems.com. Mr. Machlis, would you like to make your concluding statement?

Butzi Machlis: I would like to thank everyone on the call. Thank you for joining us today, and for your continued support and interest in our company. Have a good day, and goodbye.

Operator: Thank you. This concludes the Elbit Systems Ltd. 2022 Annual Report conference call. Thank you for your participation. You may go ahead and disconnect.

[End of conference call.]