

Q3 2006 Earnings Call

Company Participants

- Anna Cecilia Bettencourt, Head IR
- Antonio Luiz Pizarro Manso, Chief Financial Officer
- Mauricio Botelho, Chief Executive Officer and Chairman of the Board

Other Participants

- Alexander Green, Analyst
- Byron Callan, Analyst
- Daniela Bretthauer, Analyst
- Joe Nadol, Analyst
- Robert Cibdarn, Analyst
- Rodrigo Goes, Analyst
- Ron Epstein, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. and welcome to the audio conference call that will review Embraer's Third Quarter 2006 Results. Thank you for standing by.

(Operator Instructions)

As a reminder, this conference is being recorded and webcasted at www.embraer.com. 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.

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Participants on today's conference call are Mr. Mauricio Botelho, Chief Executive Officer and Chairman of the Board; Mr. Antonio Luiz Pizarro Manso, Chief Financial Officer; Mrs. Anna Cecilia Bettencourt, Head Investor Relations and Mr. (Marcello Rodriguez), the Controller. I would now like to turn the conference over to Mr. Botelho. Please go ahead, sir.

Mauricio Botelho {BIO 13386065 <GO>}

Ladies and gentlemen. good morning. Thank you for your time in joining us to our conference call to discuss the Third Quarter 2006 results in US GAAP, which were released yesterday simultaneously with the financial statement in Brazilian corporate law. My colleagues are here and I must say that we are webcasting this conference call with a slide show presentation on our website, www.embraer.com.

This quarter, it was -- we could recognize very good news at the same time that we did recognize difficulties which impacted our results. However, I think that it is very relevant to say that as a consequence of a very effective and strong commercial effort, we totalized at 135 to 137 new firm orders for the commercial airline market, including the order for HNA representing 50 EMBRAER 190 jets and 50 J145, another which represents very large and significant results, not only for its economical aspect but also because of its strategic consequence, 30 EMBRAER 175 to Republic Airways. And 6 EMBRAER 170 to Egypt Air and one EMBRAER 170 to another customer which asked us to not be disclosed.

At the same time, we advanced a lot in our presence in the (consaves) on this active aviation sector where we had more than 300 firm orders for Phenom 100 and Phenom 300. I can tell you that actually to date, our backlog on the Phenoms 100 and 300 exceeds 340 units and the Lineage today, we have six firm orders and we expect to reach year end with at least eight firm orders. We have also maintained a high level of liquidity, represented by a net cash position of over \$500 million.

In the same quarter, we also concluded an agreement with BNP Paribas in August, in month of August, in \$500 million syndicated standby facility, comprised of a 250 million Trade Finance Credit Facility and a 250 million Revolving Credit Facility available for multiple draw-downs.

This operation, specific operation has a very significant also impact on our strategy for finance behavior and performance. This will allow us to reduce loans that are more expensive than the rates that we are now considered with this loan and it will have an impact in the next months in reducing the indebtedness at the same time that we will reduce the net cash. But in terms of total financial health, this is a very positive element in our operation.

European Aviation Safety Agency, EASA, issued a type certificate for the EMBRAER 190 and EMBRAER 195 jets during the quarter. At the same time, the FAA issued that certificate for the EMBRAER 175, paving the way for deliveries to begin in the United States for this aircraft type. What we reported about one month ago were difficulties in our operation industrial process due to still difficulties in the ramp up that we were living

with. We saw difficulties with some suppliers, which impacted our ability to deliver the aircraft as we had planned. As a consequence and reported one month ago, we reduced the number of aircraft to be delivered this year to 135 aircraft.

I think that those are the most relevant highlights of this quarter, where I emphasize that in spite of all the difficulties that we were living, in spite of the difficulties in the industrial process which we are dedicating a strong action on them, we could maintain a healthy position in terms of cash and we could also penetrate in the market further in the areas of airline market and executive jet market.

We could also see in this quarter and this is something that cannot be ignored in my comments, that the defense market represented a very small contribution this year. This is a consequence of the present situation of our contracts in Brazil, where our main customer is very restrictive in their budget and when we are starting to deliver our products for other customer -- foreign customer in the last month of this year. So the consequence was that in this quarter, the total revenue coming from the defense market was very small compared with the other quarter quarters.

Based on that, I can say that overall, we still keep good results and we still keep our way in moving on and solving existing problems in a way that we can also expand our operations further. I will pass the word to Anna Cecilia, who will present now details on the results. Thank you.

Anna Cecilia Bettencourt

Thank you, Mauricio. Good morning, everyone. During Third Quarter we delivered 30 aircraft, 11 less than Third Quarter last year, due to supply chain delays and the problems already mentioned by Mauricio. Net sales this quarter reached \$894 million, a 16% decrease over the same period last year. This decrease is mainly because of lower number of deliveries in this quarter. Gross margins in Third Quarter were 28.3%, pretty stable in the comparison with Third Quarter last year and with the previous quarters of 2006.

Commercial airline still represents the most significant share of our revenue with a participation of 67% of the total. As a result of higher number of (flagger) 600 delivered in the first nine months as active aviation segment's share reached 13% of total of the company's revenues compared to 6% a year ago. In the first nine months of this year, revenues for the customer service and other segments were \$408 million and accounted for 13% of the total sales, compared to 10% a year ago. On the other hand, in the first nine months as already mentioned by Mauricio, defense government sales represented 6% of our total net revenues, compared to 12% in the same period of last year.

Due to the lower deliveries, high level of operating expense and increasing research and development expenses, income from operations the Third Quarter of 2006 were \$46 million and the operating margin was 5.2% in the period. Operating income decreased, brought the company to a net income of \$61 million in the Third Quarter and the net margin was 6.9%. Following our commitment to reduce our exposure to (breach) finance,

trade accounts receivables decreased by \$74 million and the amount related to the aircraft deliveries for which sales financing arrangements are still being (structured) represented on the \$32 million of this total amount. In addition at the end of the quarter, our total exposure to aircraft sales including customer commercial financing, was \$196 million.

Due to the production ramp up of the EMBRAER 170 190 jet family and as already mentioned, the postpone of the delivery of 10 aircraft next year, inventories increased by \$243 million and we ended the quarter with \$1.9 billion total inventory. On the other hand despite the increase in inventories, we ended September with a very strong net cash position of \$507 million. Our indebtedness didn't represent any significant movement either in the percentage of short and long term loans or in the difference between the debt in reais and foreign currency. Total debt increased close to 5%, reaching \$1.6 billion by the end of September. Our total debt average tenure was one year and 11 months at the end of September 2006.

It is important to mention two important factors. As Mauricio mentioned, we concluded during the quarter a \$500 million syndicated standby facility which we believe will result in a reduction in our overhaul cost of debt. Also, after the end of the quarter in October 2006, one of our subsidiaries, Embraer Overseas Limited, concluded an offering of \$400 million aggregate principal amount of 6.375% guaranteed loans due in 2017. With this issuance, we will be able to decrease our total debt cost and we expect to extend our debt average tenure to five years.

With the 50 ERJs 145 ordered by (Heinan) Group, we ended the quarter with a firm backlog of 55 aircraft in the Earning 145 debt family. As for the EMBRAER 170 190 jet family backlog, we ended the quarter with 359 firm aircraft to be delivered, which do not include the written orders of Northwest and Virgin Blue announced in October and November. At the end of the quarter, our firm backlog reached the record level of \$13.3 billion, reflecting the 137 new firm orders for the commercial segment and the recent announced firm backlog of the (depty) aviation segment for the Phenom family.

As we already mentioned, we revived a number of deliveries for 2006 and 2007 to 135 and 160 jets respectively. So now we will open this conference call for the question-and-answers. Thank you.

Mauricio Botelho {BIO 13386065 <GO>}

Hello?

Operator

One moment, sir.

Mauricio Botelho {BIO 13386065 <GO>}

Thank you.

Questions And Answers

Operator

(Operator Instructions)

Our first question comes from Joe Nadol of JPMorgan.

Q - Joe Nadol {BIO 3056499 <GO>}

Good morning, Mauricio.

A - Mauricio Botelho {BIO 13386065 <GO>}

Hello, Joe. How are you doing?

Q - Joe Nadol {BIO 3056499 <GO>}

Okay. A couple of questions here. I guess to start out on defense, you noted that your international sales are going to be picking up this quarter. Could you, I guess help us with what your backlog looks like or any sense of where sales might go, the quarterly sales might go in that segment?

A - Mauricio Botelho {BIO 13386065 <GO>}

Yes, sure. The defense -- our defense business is really today under pressure. We have our largest customer who is the Brazilian Air Force, who is past suffering a bad moment today in terms of budget. In this context, we have today as a going-on contract, the F50 overhaul and the production of ELX. Of course, both contracts are being delivered at a much slower rate than forecasted when the contracts were signed.

But -- and we have two methods for recognizing revenues in this area. When you have a long term development and delivery process, we have the process is as a percentage of costs incurred. When you have just practically a developed aircraft, developed product, then we recognize the revenue per unit delivered and this is the situation that we live. They have five as a long term contract with a lot of development. So its revenue is recognized on the basis of cost incurred. The ALX, it is delivered on the basis of units -- it is recognized, the revenues are recognized on the basis of units delivered and what is happening mostly in this last quarter.

We have also in this quarter, this last quarter, we started deliveries for the Colombia contract on ALX. These are the main contracts that we have in house today. Other opportunities, we are in dispute in Turkey for the (Supertucano) and that this month we received the bad news that Singapore has chosen has made their mind into another proposal rather than ours. So the situation on the defense market today is constrained by this budgetary issue and by a limited opportunity that we see abroad.

Q - Joe Nadol {BIO 3056499 <GO>}

Do you expect the Brazilian budget issues to abate at some point going into next year? I mean, how do you think that is going to go?

A - Mauricio Botelho {BIO 13386065 <GO>}

I think that even though we cannot say that it will develop strongly, I think that it is a must that it receives more support. I believe that this will happen.

Q - Joe Nadol {BIO 3056499 <GO>}

Okay. Second question is just that, since you -- since it has been a month now since we had the conference call about the 190 production issues, I am sure you are going to give us more on this later this week. But I was wondering if you could provide an update as to how the wing production is going?

A - Mauricio Botelho {BIO 13386065 <GO>}

What I can say is that we are recovering already. That is what I can say. It has been a hard game but we feel that we are climbing the hill.

Q - Joe Nadol {BIO 3056499 <GO>}

Okay. You can't tell us -- can you tell us how many aircraft you have delivered in the last month or --?

A - Mauricio Botelho {BIO 13386065 <GO>}

I can't tell you. I can tell you about that to date, the production has been much, much better than October. The production rate is much, much better than October.

Q - Joe Nadol {BIO 3056499 <GO>}

Okay. And then just finally on some of the operating expenses, was wondering if you could, I guess, clarify -- I guess on selling expense and R&D, they both came in a little bit higher than I expected. I was wondering if you could give a little bit of guidance for the Fourth Quarter there?

A - Mauricio Botelho {BIO 13386065 <GO>}

Let me explain you again something that is important to understand, what is the situation that we are living today. We are today with a very large development on three products, Phenom 100, Phenom 300, Lineage 1000. Two of them are going to have the first deliveries entering service by mid-2008. So it is a huge effort in research and development. This is a fact then that this will become -- the outcome in terms of results from this investment will start to come up by mid-2008.

Second point also is that in this executive aircraft business, we are developing a very strong action towards penetrating the market and in putting our products in different areas of the world. And this is not something that we do and have the benefit of the revenue. No, again, revenues will be just show up by 2008 on. So this is why these parameters are moving up. I think that we still have the problem of the exchange rate,

which may be with this industry area, will have a smaller impact than before. But it is still present. So these are the explanation that I can tell you. I don't see that these items will reduce in value. But they will be stable, I think, across the next month.

Q - Joe Nadol {BIO 3056499 <GO>}

So you think selling expense, which in dollars was 112 million, that is roughly the run rate through next year per quarter?

A - Mauricio Botelho {BIO 13386065 <GO>}

Yes, I believe so. I believe so.

Q - Joe Nadol {BIO 3056499 <GO>}

Okay, okay. All right. Thank you.

A - Mauricio Botelho {BIO 13386065 <GO>}

Thank you. Welcome to next week. Next week? No, this week.

Operator

Our next question comes from Byron Callan of Prudential.

Q - Byron Callan {BIO 1498699 <GO>}

Yes. Good morning Mauricio.

A - Mauricio Botelho {BIO 13386065 <GO>}

Hello Byron. How are you doing?

Q - Byron Callan {BIO 1498699 <GO>}

Good, good. How are you? I will see you later this week too.

A - Mauricio Botelho {BIO 13386065 <GO>}

Yes, sure. That will be very good.

Q - Byron Callan {BIO 1498699 <GO>}

Okay. Three quick things. First, your net cash position was pretty good at the end of the Third Quarter. Is that going to improve even more in the Fourth Quarter or how will that play out through the balance of this year?

A - Mauricio Botelho {BIO 13386065 <GO>}

I will ask Antonio to answer your question.

A - Antonio Luiz Pizarro Manso {BIO 1845027 <GO>}

How are you Byron?

Q - Byron Callan {BIO 1498699 <GO>}

Good, good Antonio. How are you today?

A - Antonio Luiz Pizarro Manso {BIO 1845027 <GO>}

Fine thanks. Our strategy is to reduce our cash in the end of this year because we (getty) by facility and to go to use our cash to reducing debt in the cash, okay? And then after, we go to reduce, okay? The net cash in the end of the year, we go to reduce for around 200, more or less.

A - Anna Cecilia Bettencourt

Byron, we are considering this standby facility as a source of liquidity. So the need to keep a higher amount in our cash won't be so necessary in our cash management strategy. Therefore, we are already paying out some of the existing debt using the existing cash that we have. In addition, we issued the bonds in October, which are also the main use of procedures to pay down debt. So if you look at the combination of both, you will see that the net cash available at the end of the period will decline.

Q - Byron Callan {BIO 1498699 <GO>}

Okay.

A - Mauricio Botelho {BIO 13386065 <GO>}

But Byron, I think that your concern maybe was if we are reducing cash, are the fundamentals for the level of cash that we always said was present in operations to be maintained? The answer is yes, because with the cash available plus the credit facility, we will be fully assisted in any eventuality that would hit the fundamentals of this strategy.

Q - Byron Callan {BIO 1498699 <GO>}

Okay. And I know we'll get this with kind of the full year look. But will you make money in the defense and government systems market this year? Was it profitable in the quarter on that sales volume? You must have some overhead that is just not absorbed when you are down at these rates? Is that a --?

A - Mauricio Botelho {BIO 13386065 <GO>}

No, of course, as if we are producing and the revenue would be just recognized for the future, I mean this quarter. In that quarter, last quarter, it was not profitable.

Q - Byron Callan {BIO 1498699 <GO>}

Okay, okay.

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A - Mauricio Botelho {BIO 13386065 <GO>}

Practically zero, more or less.

Q - Byron Callan {BIO 1498699 <GO>}

Yes, yes. Okay. And the last thing, just on the Phenom, you know you mentioned a backlog. Mauricio, if I were to put a credit card out today, when is the first open delivery positions for the 100 and the 300?

A - Mauricio Botelho {BIO 13386065 <GO>}

Make your -- apply for an order and I will tell you.

Q - Byron Callan {BIO 1498699 <GO>}

Okay, I will bring it down to Brazil. But anyway--?

A - Mauricio Botelho {BIO 13386065 <GO>}

But the fact is that we are expanding our production facility. In terms not for the production capabilities. And it will be explained at the end of this week how we are doing and how we are assuring that we will have open positions to satisfy our customers. But today, I can just tell you that is by the end of 2009, above that.

Q - Byron Callan {BIO 1498699 <GO>}

Okay, thanks.

A - Mauricio Botelho {BIO 13386065 <GO>}

You're welcome.

Operator

Our next question is from Ron Epstein of Merrill Lynch.

Q - Ron Epstein {BIO 1868102 <GO>}

Yes. Good morning Mauricio.

A - Mauricio Botelho {BIO 13386065 <GO>}

Hello Ron. How are you doing?

Q - Ron Epstein {BIO 1868102 <GO>}

Good. How are you?

A - Mauricio Botelho {BIO 13386065 <GO>}

Very well.

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Q - Ron Epstein {BIO 1868102 <GO>}

Good. Looking forward to seeing you later this week.

A - Mauricio Botelho {BIO 13386065 <GO>}

That will be great. Welcome.

Q - Ron Epstein {BIO 1868102 <GO>}

I guess a broader strategic question for you. Given the, I guess the growing pains of the 190, Embraer bringing the wing production in house, you have got basically three new business jets. One is a derivative on the plate. You have talked about maybe in the next year or so two more business jets. When do we worry that maybe there is too much development work going on? Or should we not worry about that?

A - Mauricio Botelho {BIO 13386065 <GO>}

Well, the point is -- let me clarify. The problems with the EMBRAER 190, they are not growing problems. They are reducing problems. We are facing them and it will be reduced and we will gain the war. No doubt about that. And this quarter, we already show that the production in the quarter will be much, much higher than what we had since June -- since July. So this is a part of the issue. Secondly, we are talking about on the Phenom 100 and Phenom 300 and the Lineage as well, overall rather small projects in terms of investment as to how can I say -- they are small in terms of time to deliver and they do not represent huge effort on research and development.

But what I see is that in the next -- along the next 12 months, it is very likely that we will launch at least one new aircraft between the light and the super-midsize jet. And this is again, will be a bigger commitment in terms of research and development, in terms of manpower. Because it will be a more, how can I say, a bigger aircraft with more sophisticated issues. But, at this point we are not concerned. We are fully -- we have the full capability for doing that. We have a full staff organized to adhere to those programs and we have the ability to manage them. You have been explained by this week -- at the end of this week about our industrial organization, what we are doing, what we are managing to arrange all our facilities into these programs that we have in house. I am not concerned with our ability to provide it. At a certain point, you will see that maybe the sales that are (ND) volume in our financial statements may be high. But it will pay for the investment for sure.

Q - Ron Epstein {BIO 1868102 <GO>}

Okay. And then a second question for you, Mauricio. Can you give us just an update on where the current sales campaigns are and what is on the horizon with the EMBRAER 170 and 190? Give us a feel for what is going on in the market, okay?

A - Mauricio Botelho {BIO 13386065 <GO>}

There are opportunities still to be pursued. We again, we are -- this guys that help have been paid and are shown in our balance sheet. They are working and they are present everywhere in the world. You see that we have achieved very significant results in the

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recent past, for instance penetrating in Australia, which was nothing that anybody was very much looking at. And we are expanding that in Middle East, which also represents a great victory for us. We have never been in Middle East and we already have three customers, relevant customers in the airline market over there. So we are expanding and there are always opportunities being pursued. It is difficult to say how many of them are going to be representing real orders or when these will take place. But activity keeps being high.

Q - Ron Epstein {BIO 1868102 <GO>}

Okay. And then just one more question for Antonio. Antonio, in the quarter there was about \$148 million outflow for deferred taxes. What was that? Is that temporary? If you could just could explain what that was.

A - Antonio Luiz Pizarro Manso {BIO 1845027 <GO>}

It is temporary. I got to ask myself explain today. But that is temporary in this quarter.

A - Mauricio Botelho {BIO 13386065 <GO>}

Just a minute, Ron. He is checking the figures over there.

Q - Ron Epstein {BIO 1868102 <GO>}

Great.

A - Antonio Luiz Pizarro Manso {BIO 1845027 <GO>}

We will send you later the explanation.

Q - Ron Epstein {BIO 1868102 <GO>}

Okay. Thank you.

A - Mauricio Botelho {BIO 13386065 <GO>}

Thank you, Ron.

Operator

Sir, are you ready for the next question? Mr. Botelho?

A - Mauricio Botelho {BIO 13386065 <GO>}

Yes?

Operator

Okay. Just wanted to make sure you were ready for the next question, which is from (Robert Cibdarn) of Credit Suisse.

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Q - Robert Cibdarn

Yes. Good afternoon.

A - Mauricio Botelho {BIO 13386065 <GO>}

Hello. How are you doing?

Q - Robert Cibdarn

I am well, thank you. I wanted to ask you if you could describe for us any nuance differences in selling the E jets in Europe versus the United States with the different restrictions?

A - Mauricio Botelho {BIO 13386065 <GO>}

Well, I think that the biggest difference is the size of the order. When we have in Europe, a huge order or a good order, we are talking about 10 aircraft. When are you talking the United States, it is 30 plus. But the aircraft is basically the same. We do not have significant difference from one to the other as a product.

In terms of time, I think the US market is much more aggressive in terms of achieving the results. Europeans take more time to decide and to evaluate the different alternatives. Basically this is what I see. I don't know if I captured the essence of your question.

Q - Robert Cibdarn

Well, I was thinking about that. I was also thinking with regard to the scope clauses and maybe an increased willingness on the parts of the US airlines to take aircraft -- the larger aircraft into the mainline fleet.

A - Mauricio Botelho {BIO 13386065 <GO>}

Okay, understand. In terms of scope clause, in Europe basically what you would see a concern is something above 100 seats. Up to 100 seats, you wouldn't see any restriction or any difficulty for airlines to introduce the product in their operation. In the United States, it is a different case. I think that today we have seen with the crisis, a lot of relaxation on this issue. But still with limitations. For instance, you see a huge customer, potential customer such as American Airlines, which they have just I think 25 70-seater aircraft and they are free now to operate as many 50-seaters as they want. However, imagine an airline of that size with 25 70-seat aircraft. That is, of course this is not for sure. This is not what they would demand in an open market. They would demand much more because it makes more sense for sure in several routes to have a 70-seater rather than a 50-seater.

So we still see constraints in the US market in respect to the scope clause. But as I keep saying, the common sense would ask for further relaxation, for further concessions. It will be hard. But common sense, the effectiveness of the operation, the money that the user will pay for a ticket, this would press and lead a conclusion to open more room for this aircraft in the US market. When you talk about 100 seats, you see that that will come to the main lines, not for regionals but for main lines but even though with difficulties.

Q - Robert Cibdarn

Do you think that the higher fuel price environment is making people think about the 100-seater over the 70-seater?

A - Mauricio Botelho {BIO 13386065 <GO>}

I think that in some markets, yes. But I wouldn't say that this would be something that is quite clear. Because you will always have -- I will answer it in a different way. The bottom line in an airline is very short in terms of operational margins. So it is very small. So with higher costs of fuel, then more and more we look for the efficiency in the operation and if you have a market that will be satisfied with a 70-seat aircraft, if it changed to a 100-seat, they will lose money or they will get less money than what they would. So I think that there is not a very clear picture on if there would be a prevalence of one aircraft over the other. Generally speaking in the world, we see that the 100-seater has been more attractive than the 70-seater, which for our -- which for our, I'll say, surprise, good surprise, because we thought when we developed our business plan that the 70-seater would be more attractive than the 100-seater and we are just seeing the opposite happening.

Q - Robert Cibdarn

And just as a final question, I think most people who look at the industry, study the industry think about aircraft lifespan as being 20, 25, 30 years for the larger aircraft. But of course, the regional jets are high cycle, short stage length aircraft. At what point should we start to think about a replacement cycle for the 50-seater? Will those aircraft be replaced with 50-seaters or will they generally be replaced with 70-seaters?

A - Mauricio Botelho {BIO 13386065 <GO>}

I think that some will be replaced with 50 and some will be replaced with 70 or others and at that time that this will start to happen, I think that they will be able to operate even larger aircraft. Because I think that there is a -- there will be a market for every one of the aircraft. What we see is that even though the regional jets are designed for much higher number, bigger number of cycles per year and this is true, the life perspective of this aircraft is between 35 and 30 years as well. So it is -- they are designed under the same specification of the big aircraft.

Q - Robert Cibdarn

Okay. So we are not looking at a replacement cycle any time soon?

A - Mauricio Botelho {BIO 13386065 <GO>}

Just for market needs. Not for the product.

Q - Robert Cibdarn

Understood. Thank you, very much.

A - Mauricio Botelho {BIO 13386065 <GO>}

Thank you. You are welcome.

Q - Robert Cibdarn

See you Thursday.

A - Mauricio Botelho {BIO 13386065 <GO>}

Be there.

Operator

Our next question comes from Mr. Rodrigo Goes with Banco UBS.

Q - Rodrigo Goes {BIO 6232382 <GO>}

Hi, guys. I think this question might have been answered at the very beginning of the call. But just in any case, just with regards to selling expenses as a proportion of sales, I think during the quarter that percentage reached about 12.5%. What should we expect going forward? Was that largely affected by expenses related to the fare or not so much? What should we be forecasting going forward?

A - Mauricio Botelho {BIO 13386065 <GO>}

We forecast that this level will be maintained of expense. It will be maintained in the next month because the effort that we are doing will be kept going on. While we are still intending to grow our revenues. But the absolute number will be kept at the same values.

Q - Rodrigo Goes {BIO 6232382 <GO>}

Okay. So we should expect the same absolute figure over the next several quarters? Is that--?

A - Mauricio Botelho {BIO 13386065 <GO>}

That means that as we intend to have growth and we see growth very few months ahead of us, this quarter and others, I see that proportionally to go down. But in absolute values, it will be kept along the same level that we are today.

Q - Rodrigo Goes {BIO 6232382 <GO>}

Got it. Perfect. Ok, thank you very much.

A - Mauricio Botelho {BIO 13386065 <GO>}

Thank you, Rodrigo.

Operator

Excuse me. Our next question comes from Daniela Bretthauer with Banco Santander.

Q - Daniela Bretthauer {BIO 13380169 <GO>}

Hi. Good morning.

A - Mauricio Botelho {BIO 13386065 <GO>}

Daniela, (Portuguese)

Q - Daniela Bretthauer {BIO 13380169 <GO>}

(Portuguese) Quick question on the debt profile for next year as you plan to pay down some debt with the new issuances. Do you have a sense of what would be the new cost of debt for Embraer and I just wanted to confirm, I think you said that the maturity of the debt will be five years, for next year? So, just wanted--?

A - Mauricio Botelho {BIO 13386065 <GO>}

I will pass you to Anna, Daniela. Anna will answer that. But the intent is yes, to reduce our debt cost.

A - Anna Cecilia Bettencourt

Daniela, just for you to have an idea, we are paying out with the issuance of the bond, outstanding debt with an average cost of around 8% and the bond cost was around 6.3%. In terms of average debt tenure, it is being increased -- I mean, it is expected to increase from one year and 11 months to around five years average debt tenure. So these are the figures that we can give you.

Q - Daniela Bretthauer {BIO 13380169 <GO>}

Okay. Great. And also, on the gross margin issue, just to get a sense of what would be like a guidance for gross margin that we could use as we head into 2007? Should we keep the 28% margin? Can it be slightly higher than that? Any insights on the gross margin?

A - Mauricio Botelho {BIO 13386065 <GO>}

Daniela, we are working hard in resolving the issues that are still pending. And this, as far as it happens, it will represent better margins. The target still keeps being the same, 30%. But we have to recognize that this will take somewhat longer than what we were foreseeing before. So the target for next year is to reach 30%. But it will come slowly from the point that we are now to reach the 30%.

Q - Daniela Bretthauer {BIO 13380169 <GO>}

Okay. Thank you, very much. See you on Friday.

A - Mauricio Botelho {BIO 13386065 <GO>}

That is good.

Operator

Our next question is from Alexander Green of Citigroup.

Q - Alexander Green {BIO 6487126 <GO>}

Hi. Good morning Mauricio.

A - Mauricio Botelho {BIO 13386065 <GO>}

Hello, how are you doing Alex?

Q - Alexander Green {BIO 6487126 <GO>}

I am doing well, thank you. I am on the call on behalf of Stephen Trent.

A - Mauricio Botelho {BIO 13386065 <GO>}

Send him my regards.

Q - Alexander Green {BIO 6487126 <GO>}

I will. He is in Brazil.

A - Mauricio Botelho {BIO 13386065 <GO>}

I miss him.

Q - Alexander Green {BIO 6487126 <GO>}

You will see him soon. Is there any blow back from the alleged problem from the Honeywell transponder on the Legacy?

A - Mauricio Botelho {BIO 13386065 <GO>}

I don't see -- this issue keeps being -- it is the same attitude that we are keeping from the very beginning. There is a lot of gossip, a lot of declaration statement. But there is just one authority, one group of people who has the knowledge and the ability to say anything serious about what is happening and this authority is (Cenipa), which is the Commission for -- it is the Permanent Commission for the Investigation and Prevention of Accidents. And this is the fact. We see a lot of gossip in the newspaper talking about transponder, talking about air traffic control, talking about the pilots, talking about everything. However, forget it. It is worthless to talk about that because it may but it may not be a real issue. So unfortunately, I cannot comment on that. I don't know.

Q - Alexander Green {BIO 6487126 <GO>}

All right. Thank you, Mauricio.

A - Mauricio Botelho {BIO 13386065 <GO>}

You are welcome.

Operator

Our next question is from Byron Callan of Prudential.

Q - Byron Callan {BIO 1498699 <GO>}

Hey Mauricio, I just want to follow up again on the defense and government outlook and kind of where Joe started off on this but just to kind of conclude on that outlook. What basically happened, there is a budget crunch. The Brazilian Air Force kind of said hold off a bit on the F5 upgrades, the ALX and -- but I mean, this is a timing issue? Do you think it will all get resolved and you'll just have kind of better than expected results what your prior plan was in 2007? Or is the whole program just kind of moved to the right and you are not going to be in a catch-up phase. Is that the way to think about this?

A - Mauricio Botelho {BIO 13386065 <GO>}

We are expecting to have an acceleration in the F5 program overhaul. F5 overhaul program. ALX, it is a must for the Air Force. Both programs are absolute priorities for them. We have another contract and I didn't mention this contract because it is going on on a very slow basis, which is the overhaul of the ALX. Those are the three factors that the Air Force has in their hand. So they have also the (Mehis) 2009. But the fact is that the three programs are the programs that they can expand and they can use effectively as a defense too for the country. So we are expecting an acceleration on the F5 overhaul program and we are expecting that ALX, the number of aircrafts delivered are actually bigger than those that will be happening this year.

This is -- but as I said, when you talk about government budgetary issues, it is always with a question mark. This is what we are working on it. We are having news from the customer that we are going to act like that and they are also working at that. But it is a forecast, not something that we can say it will happen.

Q - Byron Callan {BIO 1498699 <GO>}

Okay. You mentioned Turkey as one opportunity. But I think you also had an opportunity for India with special mission aircraft. I assume that is still alive and mighty?

A - Mauricio Botelho {BIO 13386065 <GO>}

It is alive. It is alive. But in India, things take bigger time, a longer time for the season. But we are there with one intelligence surveillance reconnaissance -- actually two intelligence surveillance reconnaissance programs and also other transport systems. But there it is going on, we are moving in terms of sales activities. But it takes time.

Q - Byron Callan {BIO 1498699 <GO>}

Okay. Thank you.

A - Mauricio Botelho {BIO 13386065 <GO>}

Thank you, Byron.

Operator

Our next question is from Robert Cibdarn of Credit Suisse.

Q - Robert Cibdarn

Anna, I think this is perhaps a question for you on the services side. But perhaps you could talk about the Fourth Quarter. Should we expect the same typical seasonal increase in the Fourth Quarter this year in services and perhaps you could flesh out a little bit what is in that number? How much is it dependent on the expansion of the fleet from new deliveries, etcetera?

A - Mauricio Botelho {BIO 13386065 <GO>}

Okay, Robert. Maybe it is -- I should also talk about our views on how to handle the service business. Talking about this quarter, yes I believe that it will be at the same level of what it is today. However, when I look at the future, we see service as something that will become a relevant business for us. We are today -- we have today three maintenance, repair and overhaul facilities in our hands, one in Asheville, another one in Lisbon, close to Lisbon in Portugal and another one in one of our facilities, (Gavion Preshort).

We just created a new area of concern, a new business area which will become effective from January on or from May on as far as Puerto Rico to assume the leadership of the company. This area will also become a new -- the fourth business area for us, comprising a special solution for repairs and service for customers, comprising maintenance, repair and overhaul facilities, not only for the airline market but also for the management and the expansion of the corporate -- the executive jet service centers. Training, we just announced that the (NBAA) have a joint venture with CAE to provide training service for the Phenom product pilots and we really trust that there is a lot of value to create in developing this business.

However, as everything in life, you just have to start and have to progress with determination and looking for results and every time in a challenging way, to surpass what you did the year before. So I think that strategically, this is becoming a relevant revenue and profit area of Embraer and we are dealing with it with a significant office structure as well and we'll be pursuing it in the years to come.

Q - Robert Cibdarn

Thank you.

A - Mauricio Botelho {BIO 13386065 <GO>}

Thank you, Robert.

Operator

This concludes today's question-and-answer session. I would like to invite Mr. Botelho to proceed with his closing statements. Please go ahead, sir.

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A - Mauricio Botelho {BIO 13386065 <GO>}

Thank you, very much. Thank you for all for comments, for presence on the conference call. I look forward to having all of your at our event at the end of this week. We will be extremely pleased in welcoming you and allowing that you can have your personal view on what is happening in the company. We have prepared a very good agenda for yourselves and in terms of our results, as far as it just reflects what we had announced one month before.

But I have to emphasize that the basic structures are present in our company. The significant health that we have built in terms of cash, in terms of organization, in terms of people and with our strategic view towards the future. Again, thank you very much and I will be delighted to welcome you when you come at the end of this week. Thank you.

A - Anna Cecilia Bettencourt

Thank you.

A - Antonio Luiz Pizarro Manso {BIO 1845027 <GO>}

Thank you.

Operator

That does conclude Embraer's audio conference for today. Thank you, very much for your participation. Have a good day and thank you for using (Coris Call du Brazil).

A - Mauricio Botelho {BIO 13386065 <GO>}

Thank you.

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