

Q4 2006 Earnings Call

Company Participants

- Anna Cecilia Bettencourt, IR
- Frederico Curado, CEO
- Marcello Rodriguez, Controller
- Mauricio Botelho, Chairman, CEO
- Unidentified Speaker, Unknown

Other Participants

- Christine Min, Analyst
- Heidi Wood, Analyst
- Jade Rahmani, Analyst
- Joe Nadol, Analyst
- Satish Athavale, Analyst
- Stephanie Hwang, Analyst
- Steve Trent, Analyst
- Unidentified Participant, Analyst

Presentation

Operator

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

(Operator Instructions)

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, financial trends affecting the business and its future financial performance.

These forward-looking statements are subject to risks, uncertainties and assumptions, including, among other things, general economic, political and business conditions in Brazil and in other markets where the company is present. The words believes, may, will, estimates, continues, anticipates, intends, expects and similar words are intended to identify forward-looking statements.

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Participants on today's conference call are Mr. Mauricio Botelho, Chief Executive Officer and Chairman of the Board, Mr. Antonio Luiz Pizzaro Manso, Mr. Pinheiro Fleury Curado, Executive Vice President, Airline Market, Mrs. Anna Cecilia Bettencourt, Head of Investor Relations, and Mr. Marcello Rodriguez, Controller.

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

Mauricio Botelho {BIO 13386065 <GO>}

Thank you. Ladies and gentlemen. good morning. Thank you very much for your attention. We will be discussing along this conference our Fourth Quarter 2006 results and the year-end results in U.S. GAAP, which we have released yesterday simultaneously with the financial statements and Brazilian GAAP. My colleagues are here, and we'll go through first of all for mentioning about the strategic highlights as I see them.

I think that the most relevant strategic issue, which happened this year, was the restructuring of the company, the shareholding restructuring of the company. I think that this, it was really a major event, in my opinion, the most relevant event since privatization, and with this I think we became, in fact, a global company with access to the world market in terms of finance or new capital or whatever becomes necessary.

Just two months later, we became listed in the new market of BOVESPA, which also is a relevant issue. The new market's requirements demand for the most stringent corporate governance practices, which in fact are now being taken care of. Presently, the board of directors is analyzing and discussing the ways it should operate in terms of its relationship with the officers of the company and the way to achieve autonomy, the supervisory obligations, but also to see how can they sustain and support in better way the executive officers in the proposals for the continuous growth of this company.

I think the market is receiving very well these attitudes and actions, and this could be perceived in the issues of the US\$400 guaranteed note long-term range we issued on last October. Likewise, I think the secondary offer, which was closed this February, represents also a great demonstration on the acceptance of the market on the situation of the company and the way that we have structured our shareholding organization.

I think that strategically speaking we achieved a very relevant result with the order from Hainan Airlines, HNA Group for the 50 ERJ 145s and 50 Embraer 190s last October. I say that it was very relevant because it was really the endorsement from the market on the strategy that we adopted to penetrate in the Chinese market, which is relevant by itself the way that it grows, and that same time allowed us to penetrate into the market with

the Embraer 190 before our Chinese competitor could develop an entry sales with their own aircraft.

I think that this was very much relevant, and we feel today that Embraer is well known, well accepted, not only by airlines but also by government entities and officers [ph], and we are considered part of that team. Looking at the year 2006, I think the most relevant positive aspect that we achieved was the firm order backlog. We today with the US\$14.8 [ph] billion former backlog, we demonstrate a huge economic condition. This is a record level of backlog for the company, a significant growth in the range of 40% from last year's level.

If we add the options which, in fact, are just options, but can represent the interest from the market, this backlog would go to US\$30 billion. So I think that in terms of market penetration, in terms of acceptance from the market, I think that this was a fantastic result for the company.

A relevant issue is that in the total volume of backlog, and as if we today, March this year, I'd say that 25% of it is located in countries out from the United States or regions out from Europe, which represent a very interesting and relevant dispersion of the product in different markets, which would help the company to sustain eventual difficulties that can be perceived in one market or the other. I think this was very, very, very interesting, as well.

Next we have to highlight also a problem, huge problem we had, which caused the delay in delivery of 15 aircraft from the plant [ph]. We delivered 130 aircraft, when we had planned 145 aircraft.

As we had a chance to comment beforehand, this was caused by very strong difficulties we lived with one of our suppliers responsible for the wings manufacturing in a way that by July last year we had to take the control of their operation here, assume the facility, change people, workforce, change management, changing process and systems and toolings why we keep the same old things working and a way to keep the production going on.

This caused us a very, very big impact on the Third Quarter last year, the Fourth Quarter, and will cause us an impact this First Quarter of 2007. Recovery will be seen from Second Quarter this year on. We will be hit this First Quarter as well. But it's important to say that we have now things under our control, so today we manage the plant, today we are implementing the new systems and process.

New toolings have been put together and when we talk tooling, we're not talking about screwdrivers. We're talking about complex structures that can provide a certain piece of a certain -- the comfort of having the large structural parts manufactured and supplied according to very stringent tolerances. So this demands a very large work and concentration, but today we are having it under our control. And recovery in terms of production and deliveries will be shown on the Second Quarter on.

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As a consequence, net revenues did not grow. We are about the same level of 2005, US\$3.8 billion. However, with a growth in the net cash, which reached US\$416 coming from 380 million in 2005. Net income as a consequence came down to \$390 million, which is a consequence of late deliveries and additional costs we could not manage to have without as consequential to that same specific problem. Another problem we had has to do with the exchange rate, which will be furthermore -- which will be detailed and explained in more details by Ms. Anna Cecilia later on.

In terms of commercial aviation, we achieved this year more than -- about 230 new firm orders. We had delivered an aircraft to regional airlines, U.S. Airways, Air Republic, Finnair, Flybe, Royal Jordanian, TAME from Ecuador. And every time that we say that we delivered a new aircraft for a new customer, this represents a lot of efforts and engineering and in certification also for that specific customer, more relevant achievements, as well.

If we look at the ERJ 145 family order book, we are glad to recognize at year end 53 firm order aircrafts. If we go to the Embraer 170/190, we see 410 firm order backlog at year end. And if we look at the distribution of this backlog, we would see that by far the strongest backlog, 264 aircraft, comes from the Embraer 190, showing explicitly the preference of the market for this model compared with the others. In total, this family has achieved about 620 firm orders sold so far. So we still have 410 to deliver, at that moment.

Looking to the business jet market, we are progressing as planned. We are developing the Phenom 100 and Phenom 300 at the pace that we forecast. The level of firm orders are quite good today. Today, March, we are in the range of 400 firm orders aircraft for both of the aircraft, and the Lineage as well is progressing at a very reasonable way.

Today we achieved, March, and again, we achieved the seven firm orders and still letters of intent being discussed and contracts being discussed. By year end, probably can get two more in our books. The first [ph] in government is an area of concern. It is -- this area is strictly related to governmental budgets, and this is a problem everywhere, in every country.

In Brazil, as well, in this side, and with this customer, the Brazilian Air Force, we have progressed with the F-5 BR overhaul aircraft deliveries and the Super Tucano deliveries and, however, we had the first deliveries for the Colombian Air Force. We delivered five first Super Tucano to this customer. We also have contracts such as data links developed for the Brazilian Air Force, which keep us going on, while not at the volume that we would like to have.

We also start to look in this area in selling our commercial or executive jets to different governments around the world. This has proved to be successful. We are using the same selling structure, sales structure. We are putting our aircraft into different markets, which is spreading the base, our customer base, as well. Legacies, Embraer 170s, Embraer 190s are spread in different countries now, using this same organization.

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Customer services is an area which is expanding at a very interesting pace. By April this year, this area will be recognized as a new business area, together with the commercial aircraft, airline aircraft, business jet and defense, there will be this fourth area, services. We will be expanding -- we already expanded our Nashville facility to be able to maintain repair and overhaul our Embraer 170/190 aircraft. This is already done.

We are expanding our service organization to include three more service organizations in the United States and one more in Europe, and we qualified and certified 35 third-owned [ph] service centers in the world, mainly in the U.S. and Europe, to assist our executive jets. As well, we'll then file [ph] training as a potentially very interesting business, mainly because of our executive jets. Very light jets, such as the Phenom 100, will be operated not only by organizations, shuttle companies and air taxi companies, but in a large extent by individual owners.

And as that, we have to consider that maybe nonprofessional pilots will be operating these aircraft and training, assuming an important part of the business. We have signed last year with CAE Systems from Canada a joint venture agreement to form a global training joint venture to provide a pilot and ground crew training to Embraer customers of the Phenom jet. This is an interesting step forward in terms of service organization.

In engineering, looking to engineering, every time that we have to deliver a first aircraft to a new client, to a new customer, there is a lot of back office work to be done in terms of certification and in terms of regarding the new configuration of that alloy. And the Embraer 195 received certification from CTA in Brazil and the EASA in Europe and first deliveries were made to Flybe and Royal Jordanian Airlines.

The Embraer received type certification from EASA and first deliveries are made to Regional, an Air France subsidiary, and Finnair. (inaudible) now our concentration and effort is in regaining the productivity that we have shown in the past, taking care of the production problems that we had to face, taking care of our supply chain in a way to back up the growth that we are committed to.

What I can say is that we see it with confidence and, as I said, we see results coming on from the Second Quarter of this year on. I'll pass the word now to Anna Cecilia Bettencourt, who will present the financial results, and I will be then back to answer questions and answers, as usual. Thank you very much.

Anna Cecilia Bettencourt

Thank you, Mauricio. Good morning, everyone. As already mentioned by Mauricio, due to the deficiencies related to the difficulties related to the (inaudible) of the wing of the Embraer 190 and the Embraer 195, the aircraft, as well as supply chain delays, we delivered 130 jets in 2006, compared to 141 delivered in 2005.

During the Fourth Quarter 2006, we delivered 37 jets, being 25 to the commercial aviation market, ten Legacy 600 and two to the defense and government market. In 2006, net revenue related to the commercial aviation segment reached \$2.4 billion, and

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represented 64.4% of our total revenues, compared to \$793 million -- compared to \$2.7 billion and 70.6% respectively a year ago.

As a result of a higher number of Legacy 600s delivered, net revenues for this extra aviation [ph] was doubled, reaching \$582 million, compared to \$270 million in fiscal year 2005. Due to the expansion of our facility in Nashville, Tennessee, as well as the recent acquisition of OGMA, our operations in Portugal, net revenues from customer service and other segments in fiscal year 2006 reached \$545.6 million, compared to \$422 million in 2005. This means this business accounted for 14.3% of our 2006 net revenues, compared to 11% a year ago. On the other hand, the net revenues from the defense and government segment decreased its participation [ph] from 11% in 2005 to 6% in 2006.

As Mauricio mentioned, a very important milestone is being achieved, which is the revenue diversification by region, as well. As this year, we delivered aircraft to customers in different regions of the world, revenues from Europe increased from 14.6% to 22.1% in 2006. Other regions, such as Middle East, Asia, Latin America, increased its share from 10% in 2005 to 16.9% this year, while North America decreased its participation from 67% to 57% this year.

Additionally, due to the lower sales to the Brazilian Air Force, the Brazilian market decreased from 7.9% in 2005 to 3.8% in 2006. As a result of our lower of aircraft delivered, net revenues reached \$1 billion during the Fourth Quarter 2006, representing 8.9% decrease over the same period in 2005. For the fiscal year 2006, it reached \$3.8 billion, compared to more or less the same amount a year ago.

The production issues already discussed resulted in an increase in our production costs, increased industrial cost, causing a negative impact on our gross margin, which decreased to 27.5% in the Fourth Quarter 2006, compared to 28.2% in the same period in 2005. At the end of 2006, our gross margin was 28.1%, compared to 30% in 2005.

Therefore, due to lower revenues and increased selling, administrative and research and development expenses, income from operations decreased from \$508 million to \$308 million. Selling expenses increased as a result of our effort to support the commencement of the Embraer 190 model operations, as well as the implementation of a dedicated sales force and marketing strategy to promote the Phenom jet.

In addition to the progress in the development of the Phenom family and follow-on certifications for the Embraer 170/190 family, research and development expense for full-year 2006 reached \$112.7 million, compared to \$93.2 million in 2005. G&A expenses increased by 16% from \$205.2 million in 2005, to \$235.5 million in 2006, due to a 5.7% wage increase in payroll in 2006, and a 10% average appreciation of the Brazilian-U.S. dollar exchange rate in the same period.

On the other hand, despite the decrease in our operating, net margin reached 10.2% in 2005, due to a higher net financial income and lower effective tax rates. The high acceptance of our aircraft and recovery of sales finance in markets, we ended 2006 with no aircraft in accounts receivables.

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Inventories were affected by the production difficulties related to the final assembly of the wings of the Embraer 190 and 195, and by a higher number of aircraft in the final assembly state, so inventories reached \$2 billion at the end of the year, compared to \$1.5 billion at the end of 2005.

Considering our free cash generation of \$439 million in 2006, we paid off some of our debt. In addition, as part of our financing strategy in October of 2006 Embraer Overseas Limited, a subsidiary of Embraer, issued \$400 million guaranteed notes due in 2017 [ph], which allowed us to extend our debt maturity required from four years and five months.

As a result, again, of our free cash flow generation, our net cash position increased from \$360 million at the end of 2005, to \$460 million in the same 2006. In addition, as part of our financing strategy, we concluded a \$500 million syndicated standby credit facility, which increases our liquidity, allowing us to pay out more debt, which we believe will result in a reduction of our overall cost of debt.

Backlog and deliveries. As Mauricio mentioned, we ended the year with a record firm order backlog of \$14.8 billion, which represents 3.9 times our 2006 revenues. Aircraft deliveries, we are maintaining our aircraft deliveries, so we expect to deliver in '07 between 165 and 170 jets, and for 2008 we expect to deliver between 195 or 205 jets, which will include the first deliveries of the Phenom 100, which we expect to deliver between 20 and 25 jets.

So now, we will open this presentation for questions and answers.

Questions And Answers

Operator

(Operator Instructions)

Our first question comes from Joe Nadol from JPMorgan. Hello, everyone.

A - Mauricio Botelho {BIO 13386065 <GO>}

Hello, Joe, how are you doing?

Q - Joe Nadol {BIO 3056499 <GO>}

My first question, Mauricio, you mentioned in your comments, you noted that you have \$15 billion worth or so of options, and some of these are for 145s that obviously aren't going to be exercised anytime soon, but a lot of them also are for 170s and 190s. I'm wondering if you can say in the 2008, 2009 timeframe what the value of options for 170s and 190s is for those years, and when we may start to see some option conversions.

A - Mauricio Botelho {BIO 13386065 <GO>}

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Joe, we already started to see options conversion. During this year, I think we had already announced confirmation of options from some customers, if we're not; Frederico just mentioned to me -- 40, 4-0 options were converted this year. So last year, you mean, Marcello? 2006. 40 options on 2006 were already converted. This year, we expect to have already something to be converted, maybe somewhere still in the final part of the customers ask to be relieved, not at this point, but we would see this confirmed soon.

Options conversion is something that is absolutely uncertain. Any forecast that I can tell you is not solid. It cannot be based on -- it's not fair judgment that comes here. But I believe, it is a matter of belief, it is a matter of the trust that we have and the capability of the customer to grow. We believe that a portion of them, a good portion of them, will be converted.

Q - Joe Nadol {BIO 3056499 <GO>}

Well do you have -- this year, during 2007, do you have a number of those options expiring, where they would either have to be converted or they would be lost?

A - Mauricio Botelho {BIO 13386065 <GO>}

Fred will answer you Joe [ph].

A - Frederico Curado {BIO 2004589 <GO>}

Hello, George. Fred here.

Q - Joe Nadol {BIO 3056499 <GO>}

Hi. Freddie.

A - Frederico Curado {BIO 2004589 <GO>}

Hi. Specifically, Joe, we have an 18-month lead time for our option confirmation, so, yes, we do have the option of expiring in a confirmation days [ph] expiring this year. 2007 we are sold out [ph] so obviously we have no options. Those lots reserved for any option in 2007, we have a few of them in 2008, and those are going to expire in the next few months.

Q - Joe Nadol {BIO 3056499 <GO>}

Next few months.

A - Frederico Curado {BIO 2004589 <GO>}

Yes. They're going to come due, either confirmed or not confirmed in 2007 [ph], but that's not too many. Because if you take a typical 18-month lead time, as we approach the middle of the year, it pretty much takes care of the rest of 2008.

Q - Joe Nadol {BIO 3056499 <GO>}

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Okay, okay. Second question is on the defense sector. Mauricio, you noted that it's a concern, given the tight defense budgets. Are you still confident that sales in that sector are going to bounce back and grow this year, though, to give that big Colombian contract? Do you still expect growth in that sector, material growth in 2007, versus 2006? And maybe the problems that you are citing might be more of a 2008 revenue issue.

A - Mauricio Botelho {BIO 13386065 <GO>}

What I see in fact, is that this year I don't expect any significant growth. The Colombian contract, of course, will add something, but, as you answered you on the material growth, I don't believe it to come.

We re participating in some dispute, for instance, in Turkey, for a separate Tucano deal. We expect to have a definition by midyear, and that is a very good order, in the range of something like \$450 million, but the effects of that order will be felt more next year rather than this year.

Q - Joe Nadol {BIO 3056499 <GO>}

Okay. Then finally, just one financial question on the quarter itself. In selling expenses, actually, they came in lower than expected, and you noted in the press release that there was some reversion of financial guarantees. Can you quantify what that number was?

A - Mauricio Botelho {BIO 13386065 <GO>}

Yes, Marcello is going to answer you.

A - Marcello Rodriguez

Yes. It's around \$20 million reversal for guarantees that was in the commercial expense.

Q - Joe Nadol {BIO 3056499 <GO>}

So that negated some of the expense, that was a positive to your earnings of \$20 million.

A - Marcello Rodriguez

Yes.

Q - Joe Nadol {BIO 3056499 <GO>}

Okay. All right. Thank you, gentlemen.

A - Mauricio Botelho {BIO 13386065 <GO>}

Thank you, Joe, good to talk to you.

Q - Joe Nadol {BIO 3056499 <GO>}

Good speaking with you.

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Operator

Our next question comes from Heidi Wood with Morgan Stanley.

Q - Heidi Wood {BIO 3095506 <GO>}

Hello. Good morning.

A - Mauricio Botelho {BIO 13386065 <GO>}

Hello, Heidi, how are you doing?

Q - Heidi Wood {BIO 3095506 <GO>}

Hello, Mauricio. I'm good. I'm good. Before I begin my question on the company, is this the last conference call, Mauricio, that we're going to have you on?

A - Mauricio Botelho {BIO 13386065 <GO>}

I would say this is at the very end, but I have to thank all of you for years of consideration.

Q - Heidi Wood {BIO 3095506 <GO>}

Then I have to say that it's been an absolute pleasure to have you. And while we're going to enjoy Freddie very much, you're going to be missed. So thanks for a great job that you've done for all these years for Embraer. It's been a fantastic run.

A - Mauricio Botelho {BIO 13386065 <GO>}

Thank you, Heidi, thank you very much.

Q - Heidi Wood {BIO 3095506 <GO>}

So getting on to the questions about the company, I wondered if -- I'm going to go to the old traditional questions, if you could characterize for us what you think the pace of order demand is going to look like this year, a little bit contrasting it versus last year and what percentage of your slots? I know Freddie said that the slots are filled for '07. I'm curious as to what percentage of your slots are filled in 2008.

A - Mauricio Botelho {BIO 13386065 <GO>}

I will pass the word to Fred to answer your question, Heidi.

A - Frederico Curado {BIO 2004589 <GO>}

Hello, Heidi, how are you?

Q - Heidi Wood {BIO 3095506 <GO>}

Great, Freddie.

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A - Frederico Curado {BIO 2004589 <GO>}

Can you listen to me well?

Q - Heidi Wood {BIO 3095506 <GO>}

I can hear you, yes.

A - Frederico Curado {BIO 2004589 <GO>}

We have about probably today about 80%-plus of '08 already committed to firm to us (inaudible) orders per segment is in that order of magnitude.

Q - Heidi Wood {BIO 3095506 <GO>}

Okay. Great. And what does the order demand look like this year?

A - Frederico Curado {BIO 2004589 <GO>}

Usually, at the beginning of each year, it's a little bit slower than the rest of the year, '07 has been different, so it's a positive. There's a lot of activity out there. We do expect to have, as Mauricio alluded to, a confirmation of options rather soon, and there's a lot of activities actually all over the world. It's pretty much spread geographically wise.

So we are certainly targeting to have at least a 1 to 1 ratio in terms of the backlog and new orders. This is certainly our goal to keep at a minimum, and of course it's a bit early in the year to make more stronger commitments, but it looks good.

Q - Heidi Wood {BIO 3095506 <GO>}

Okay. Great. Then one other question. It's nice to see this growth in overhaul and repair, and obviously that's been helped because you bought some properties and you've been expanding. Can you talk a little bit about how you see this business growing organically over the next couple of years, and also remind us the margins on this business?

A - Frederico Curado {BIO 2004589 <GO>}

Well we have to separate -- this business is actually comprised into three focuses, one being better spare parts and total care packages, second, maintenance, repair and overhaul, and the third, training. With training, in those two we kind of have to talk about each individually. Training certainly is going to be much deeper than organic growth, because growing from five [ph] almost to zero and you have a full of (inaudible).

And so that's going to grow, especially as we start to introduce the Phenom aircraft into the market next year. With that joint venture we have with CAE for the Phenom training, we do expect this joint venture to have the leadership and the training from their aircraft. That is a business that we are not in today, and we also are doing some investments in training for the E-jets.

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We are moving, as we speak, a simulator, our simulator, which is currently sitting in Montreal, all the way up to Singapore, and by midyear we shall start having some revenue train there. So that's the perspective on training. Maintenance and overhaul -- and training, we expect to have -- it's a more comfortable margin business.

Maintenance, repair and overhaul, it's a business where on a component side, on a repair components side, it's relatively attractive margins as well. On the heavy maintenance side, it's a very competitive business. So the way we are strategizing this is really to try to mesh [ph] this into total care packages where we can associate our maintenance packages with the supply of parts, and have kind of a pay per hour type of arrangement with our customers.

It applies both to the airline market and also to the executive market. And spares, of course, is a continuous business. We've been there for a long time. We are enhancing our portfolio of offers, having like two programs, again, hour by the hour type of programs, and it is a growth area. So overall, in terms of percentage, maybe we can see a more than organic growth in that area, but again, we are starting from a very high number of size, so we want to do [ph] something significantly higher than it is today in the next few years.

We're investing a lot in the infrastructure for the executive jets, so it's going to take a few years to have that mature. Then as the fleet grows, then we'll have some more significant numbers.

Q - Heidi Wood {BIO 3095506 <GO>}

All right, but in terms of the growth rate, should we see that as a high single-digit -- when we roll that all up, can you do high single digits in that area?

A - Frederico Curado {BIO 2004589 <GO>}

I probably would expect that to grow in average probably at least at the same pace as the company.

Q - Heidi Wood {BIO 3095506 <GO>}

Okay.

A - Frederico Curado {BIO 2004589 <GO>}

You should not see a decrease in the percentage of that business as the company grows [ph].

Q - Heidi Wood {BIO 3095506 <GO>}

All right, and do I hear you correctly -- this is the final question and I'll let someone else get in. But did I hear you correctly, that it sounds like you're investing a lot in infrastructure, does that include additional M&A that you may be involved in to expand your reach?

A - Frederico Curado {BIO 2004589 <GO>}

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No. That addresses basically four new service centers for the executive aviation. Three are in the U.S., one in Europe. That addresses the joint venture that I mentioned to you for the training and the spare parts, inventory and things like that. So we're not considering any acquisitions at this stage.

Q - Heidi Wood {BIO 3095506 <GO>}

All right, great. Thanks very much guys, and, again, nice quarter.

A - Mauricio Botelho {BIO 13386065 <GO>}

Thank you.

Operator

Our next question comes from Byron Callan with Prudential.

Q - Jade Rahmani {BIO 16047861 <GO>}

Yes. This is Jade Rahmani on for Byron. I was wondering if you could provide an update on the status of the SAP implementation? What's the time to completion and how's that going?

A - Mauricio Botelho {BIO 13386065 <GO>}

Marcello is taking care of that, SAP.

A - Marcello Rodriguez

We implemented SAP on the 1st of July. It was a worldwide implementation considering all of the production models, engineering interface, which was very highly changed the programs to make the interface. Of course, it's a learning process. We are adjusting our operation to it, but I think it's improving lot since its implementation.

Q - Jade Rahmani {BIO 16047861 <GO>}

On CapEx, which came in higher than we had expected in the Fourth Quarter, can you provide any color on what drove that increase, and if this is a one-time pickup, or should spending remain elevated in Q1 and into the latter [ph] parts of '07?

A - Anna Cecilia Bettencourt

Yes. Actually what is happening in terms of CapEx investment in PP&E, is that we assume the CapEx active production [ph] in August and we started already to make some investments, mainly in November and December.

In addition, there were some adjustments in our production in terms of (inaudible) but nothing in a magnitude that was not unexpected by the company itself. And for this year we are forecasting \$194 million investments of PP&E. Mainly it's related to productivity and

production related to production ramp up, and investments related, also starting [ph] investments on the customer service portion of the business.

Q - Jade Rahmani {BIO 16047861 <GO>}

Okay. Great. And just the final question on G&A expenses, aside from the currency appreciation and the increase in wages, was there anything else that drove that higher? And as a percent of sales are you expecting it to kind of remain in the kind of area for the first half of '07?

A - Mauricio Botelho {BIO 13386065 <GO>}

Marcello is about to explain to you about this, okay.

A - Marcello Rodriguez

Yes. As you mentioned, we had the effect of exchange rates. We had also an increase on the wages that we always could find at the end of the year, in November, and at the same time have developed provisions related to the wage, also updated with this increase, and you have the net increase of the operation itself.

A - Anna Cecilia Bettencourt

And also the implementation of the SAP that occurred this year, which Marcello already mentioned.

Q - Jade Rahmani {BIO 16047861 <GO>}

Great. Thanks very much.

A - Anna Cecilia Bettencourt

You're welcome.

Operator

Our next question comes from Ron Epstein with Merrill Lynch.

Q - Stephanie Hwang {BIO 17680552 <GO>}

Hi, this is actually Stephanie Hwang. Ron's actually out in California. I actually just had one quick question. The R&D in the quarter was still about 3.3% of sales, even though supplier contributions was about 2% of sales. Can you elaborate on sort of what else is going on and then kind of remind us of what you're expecting for 2007?

A - Anna Cecilia Bettencourt

Yes, starting from the end of your questions, we expect in terms of R&D for '07 to reach \$237 million gross, so we are not including this amount of contribution from suppliers or anything else. So in the commercial aviation, due to the final specifications for the E-jet family, we expect to invest \$51 million.

In executive aviation, which is the bulk of our investment with the development of the Phenom and also the Lineage 1000, we expect to invest \$127 million, while in technology development -- research and development, technology, we expect to invest \$59 million in '07.

So R&D expense this year also we received contribution -- we recognized offsetting the total research and development expense contribution from risk-sharing partners as long as we keep achieving certain milestones with these suppliers, we offset the total research and development in specific periods. So this year, we recognized \$36 million, which offset the year's R&D.

And also, you have to take in consideration that when we assumed Capazak's [ph] operations also we received the contribution from them in the total amount of \$55 million, approximately.

Q - Stephanie Hwang {BIO 17680552 <GO>}

Okay. Thank you.

A - Anna Cecilia Bettencourt

You're welcome.

Operator

Our next question comes from Christine Min, Calyon Securities

Q - Christine Min {BIO 5802066 <GO>}

Hi, thank you.

A - Mauricio Botelho {BIO 13386065 <GO>}

Hello. Good morning.

Q - Christine Min {BIO 5802066 <GO>}

In the gross margin line, was the decline all due to the supply chain related delays, or was there some effect on the appreciation in the real, as well?

A - Mauricio Botelho {BIO 13386065 <GO>}

From both.

A - Marcello Rodriguez

Yes, depreciation.

A - Anna Cecilia Bettencourt

There was some related to the exchange rate, but I would say that largely impacted by the production.

Q - Christine Min {BIO 5802066 <GO>}

Okay, so then are you still targeting a gross margin close to 30% towards the second half of this year or --?

A - Marcello Rodriguez

Yes. We waited to achieve that in the last quarter of this year.

Q - Christine Min {BIO 5802066 <GO>}

Okay. Great, thank you. And my last question is are you planning to make any investments on the MRO side in China as well?

A - Mauricio Botelho {BIO 13386065 <GO>}

Not at this moment. We don't have any plans at this moment.

Q - Christine Min {BIO 5802066 <GO>}

Okay. Thank you.

A - Anna Cecilia Bettencourt

You're welcome.

Operator

Our next question comes from Satish Athavale from KSA Capital.

Q - Satish Athavale {BIO 16105944 <GO>}

Good morning.

A - Mauricio Botelho {BIO 13386065 <GO>}

Good morning, how are you?

Q - Satish Athavale {BIO 16105944 <GO>}

Good, thank you, doing well. My first question is for Anna. Anna, what was the income tax benefit on the employee profit sharing plans in the quarter?

A - Anna Cecilia Bettencourt

I'm going to turn to Marcello, which is the Controller. He will be able to answer the tax benefit that we recognized this quarter.

A - Marcello Rodriguez

Just a moment, please.

A - Anna Cecilia Bettencourt

I'm sorry, you were mentioning the profit sharing provision that we made this quarter?

Q - Satish Athavale {BIO 16105944 <GO>}

Yes.

A - Anna Cecilia Bettencourt

I'm sorry, I thought that you were mentioning tax. I'm sorry. A total of \$16.5 million [ph] in the Fourth Quarter 2006. In total, for the year 2006, was \$42.7 million.

Q - Satish Athavale {BIO 16105944 <GO>}

So that was the tax benefit during the quarter, 16.5 --?

A - Anna Cecilia Bettencourt

No. This is the profit sharing.

Q - Satish Athavale {BIO 16105944 <GO>}

No. I mean, I am asking how much was the reduction in your taxes because of this contribution?

A - Anna Cecilia Bettencourt

It's an expense.

A - Unidentified Speaker

It's an expense, so there are no special incentives.

A - Anna Cecilia Bettencourt

These are [ph] profit sharing is an ordinary expense like any administrative expense, like payroll. Maybe you are mentioning about the interest rates on shareholders' capital interest.

Q - Satish Athavale {BIO 16105944 <GO>}

Well I was referring to your income tax expense line. It was actually a benefit, tax benefit this quarter, versus a positive tax payment last quarter.

A - Marcello Rodriguez

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Okay, so let's explain the income tax revenue at that case. We have the impact of the R&D expenses, where we have an influence on the income tax because we have an incentive that we can expense in a lump sum the moment of the expense. At the same time, we have an incremental deduction for the R&D here, so we have this temporary and permanent affect on the R&D.

So the interest on capital also, it's acceptable interest that you can apply against the income tax expense, so it also has an influence on the income tax.

Q - Satish Athavale {BIO 16105944 <GO>}

Okay. And how much was the interest on capital?

A - Marcello Rodriguez

The impact on the year was -- let me do the --.

A - Mauricio Botelho {BIO 13386065 <GO>}

Just a minute, please.

A - Marcello Rodriguez

It's something around \$50 million, the impact on just the interest on capital, \$50 million on the tax expense.

Q - Satish Athavale {BIO 16105944 <GO>}

And that goes [ph] for the full year, is it?

A - Marcello Rodriguez

Yes.

Q - Satish Athavale {BIO 16105944 <GO>}

Okay, good, and then second time that I want to get is the insurance benefit. Was that during the Fourth Quarter, or was that throughout the year? And how much was it?

A - Marcello Rodriguez

It was in the Fourth Quarter. I think it was around \$12 million or \$15 million.

Q - Satish Athavale {BIO 16105944 <GO>}

Okay. Then, Mauricio, can you comment on your sales campaigns that you are in currently, and kind of how does the outlook develop over the next couple of quarters?

A - Mauricio Botelho {BIO 13386065 <GO>}

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I think that just what I can say is it is very busy everywhere in the world. It is busy not only in the commercial aircrafts, as well as in the executive jets. It's prices issues in Asia, India, Europe, the United States, Latin America. So it is Brazil. It is very, very strong, but as always, very difficult to predict what or when is going to come up in the near future.

Q - Satish Athavale {BIO 16105944 <GO>}

Okay. Great, thank you.

A - Mauricio Botelho {BIO 13386065 <GO>}

Thank you, Satish.

Operator

Our next question comes from Steve Trent with Citigroup.

Q - Steve Trent {BIO 5581382 <GO>}

Good morning, all. And -- hi. Good morning, everybody, just one or two quick questions from me. Looking at what's been developing in terms of potentially emerging competition, Bombardier has come out with the announcement of a moderately bigger 100-seat jet. China and Russia, you're sort of seeing some similar developments over the medium term, and I'm just wondering, what's your opinion on the strategic landscape, especially in the Chinese and Russian markets?

A - Mauricio Botelho {BIO 13386065 <GO>}

I see that in China and Russia, they are developing their programs. I think that the Russian program is developing, will have an entry service earlier than the Chinese one. But two years ahead of us for the Russian, three years ahead of us for the Chinese, and the Canadian one, two years ahead of us, about --. 2010? Okay, 2010. Fred is correcting me. At least you have a CEO, who speaks a much better English than I do.

A - Frederico Curado {BIO 2004589 <GO>}

Steve, there not ahead of us -- definitely not ahead of us.

A - Mauricio Botelho {BIO 13386065 <GO>}

They're behind us, yes.

Q - Steve Trent {BIO 5581382 <GO>}

I figured that's what you meant.

A - Mauricio Botelho {BIO 13386065 <GO>}

But do you speak Portuguese?

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Q - Steve Trent {BIO 5581382 <GO>}

(foreign language).

A - Mauricio Botelho {BIO 13386065 <GO>}

But that's -- in fact we will start to see these aircraft by the beginning of 2010 at least, minimum.

Q - Steve Trent {BIO 5581382 <GO>}

Okay. Great.

A - Mauricio Botelho {BIO 13386065 <GO>}

Just for another [ph] comment here, Steve, if you allow me. In China, we got a tremendous -- I think a tremendous achievement. We will have our 100-seat Embraer 190 aircraft flying there before theirs. Second, I think that when I look to the Canadian aircraft, it is already a stretch of the 50-seat aircraft, so 50, 70, 86, 100, I think that you can imagine the sort of comfort provided to passengers and how can this be very well accepted. For sure, I think it will take some orders, for sure.

But it is the savings, operational savings, that they are announcing that's not the correct number, much, much lower than what they are presenting, but that will be a market for that. So what I see is that our product line from the 70 seater up to 100 seats, 122 seats, they're doing well. They'll keep doing well in the next two years. Our market share will be bigger in the next two years, and we think that the competitiveness of our aircraft will be kept in place.

Q - Steve Trent {BIO 5581382 <GO>}

Great. Well I appreciate that, and while I think that Freddie Curado is an extremely capable professional, I am darn well going to miss Mauricio. I echo Heidi Wood's comments, and best of luck to you both.

A - Mauricio Botelho {BIO 13386065 <GO>}

You all are very nice, thank you.

Operator

(Operator Instructions)

We have a question from Darren Shannon [ph] with Blythe [ph].

Q - Unidentified Participant

Mauricio, how are you doing, sir?

A - Mauricio Botelho {BIO 13386065 <GO>}

How are you doing?

Q - Unidentified Participant

I'm fine, sir.

A - Mauricio Botelho {BIO 13386065 <GO>}

It's good to speak to you.

Q - Unidentified Participant

And you, as always, and congratulations and good luck.

A - Mauricio Botelho {BIO 13386065 <GO>}

Thank you.

Q - Unidentified Participant

I want to ask you guys about the implications of this cargo door issue that came up with Air Canada and JetBlue. How is the development of the new piece going, and is there a cost projection at all?

A - Mauricio Botelho {BIO 13386065 <GO>}

Fred will take care of it.

A - Frederico Curado {BIO 2004589 <GO>}

Well first of all, it's very important to remark with absolutely no doubts, there is no safety issue in relation to that door. That door was by the way the door which was used in our (inaudible) pilot's cage door, so the door, I mean, the aircraft is clear to the full envelope, even with the door wide open, which, of course, did not happen. Now, even if it happens, the aircraft is absolutely handle-able with that situation as well.

Putting that aside, we are enhancing the design by repositioning just the sensor that gives us a positive indication that our door latched and locked, and this shall be accomplished in the next probably two or three months in the whole fleet [ph]. So in a little while, we took the initiative just to make sure that no incident can be repeated, that we have a positive clearance indication of the door locking, so we published this alert bulletin, followed by an AD, so we are warranted [ph] operationally, and we have a final design fixed by, as I said, probably around three months.

Q - Unidentified Participant

Sorry, can you just clarify it again? It broke up a little bit there. You said you were repositioning what?

A - Frederico Curado {BIO 2004589 <GO>}

The sensor. The sensor that gives the indication the cockpit of the door lock, latched and locked.

Q - Unidentified Participant

And is there a cost projection on this at all?

A - Frederico Curado {BIO 2004589 <GO>}

I don't have a figure. It's not such a big deal, frankly, and this is an item which is produced by Lataclar [ph] by the way, and it's not a major design. It's just the reposition of a sensor.

Q - Unidentified Participant

Okay. Thank you both very much. And Fred, good luck.

A - Frederico Curado {BIO 2004589 <GO>}

Thank you very much. I'll need it.

A - Mauricio Botelho {BIO 13386065 <GO>}

Thank you.

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.

A - Mauricio Botelho {BIO 13386065 <GO>}

Thank you very much. Ladies and gentlemen. my good friends. For years you have attended to our conferences, personally, our conference calls, and I have to thank all of you for the great support you have given, the criticisms, the support, the ways that you look at it. We learned a lot with all of you.

And I think that at this time that I will be leaving the company one month from now -- leaving the company as a CEO, I will make this remark, very strong remark, because I'll be taking a good look at Fred all the time, supporting him as the Chairman of the company, at least until 2009. But at this moment, I want to thank you very much for all the good moments we lived and for all your attention. Thank you. Good luck for all of you.

A - Anna Cecilia Bettencourt

Thank you. And we would like also to invite you all to our Embraer Day [ph] (inaudible) which will happen on April 11th -- on April 11th. So you probably received already the invitation, and for the ones that did not receive, just let us know and we will send you the proper invitation. Thank you. And I will see you in April, then.

A - Marcello Rodriguez

Thank you, bye-bye.

A - Mauricio Botelho {BIO 13386065 <GO>}

Goodbye.

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 Chorus Call Brazil.

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