

WEG S.A.

4th Quarter 2017 Earnings Results Conference Call

March 1, 2018 – 11:00 a.m. (Brasilia time)

Transcript of the simultaneous translation from Portuguese into English



## CORPORATE PARTICIPANTS

**Mr. André Luís Rodrigues** – Managing Director  
Financial Superintendent

**Mr. Paulo Polezi** – Finance and Investor Relations  
Officer

**Mr. André Salgueiro** – Investor Relations  
Manager

## PRESENTATION

**Operator:** Good morning ladies and gentlemen and welcome to WEG's 4Q 17 results conference call.

### Conference Call 4Q17

Improved business dynamics and  
return on invested capital



We would like to inform you that this conference call is being recorded and all participants are in listen-only mode. Ensuing this we will conduct a question-and-answer session when further instructions will be given to participate.

Should you require any assistance during this call please press star zero to reach the operator. We are simultaneously webcasting this conference and the accompanying slides at our side [ir.weg.net](http://ir.weg.net). As a reminder we are recording this conference and after the conclusion the audio will be available at our IR website. Journalists should direct their questions to the press office at the number (47) 3276 4295.

### Disclaimer

*This is a support document for the WEG S.A. 2017 fourth quarter results conference call.*

*Any forecasts contained in this document or statements that may eventually be made during this conference call relating to WEG's business perspectives, projections, and operating and financial goals, and to WEG's potential future growth, are management beliefs and expectations, as well as information that is currently available.*

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Any forecasts contained in this document or statements eventually made during this conference related to WEG's business perspectives, projects and operating and financial goals and WEG's potential future growth our management believes and expectations and are based on information currently available. These statements involve risks, uncertainties, assumptions and they depend on circumstances that may or may not occur.

Investors should understand that general economic conditions, industry conditions and other operating factors may affect WEG's future performance and lead to results that differ materially from those expressed in such forward-looking considerations.

We would like to remind you that this conference call will be conducted in Portuguese with simultaneous translation into English.

With us today and Jaragua do Sul we have Mr. Andre Luis Rodrigues, Managing Director, Financial Superintendent; Mr. Polezi, IRO and Mr. Salgueiro, Investor Relations Manager. You may proceed Mr. Rodrigues.




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**Mr. André Luís Rodrigues** – Managing Director  
Financial Superintendent

Good morning to all of you and it is a pleasure to be with you to release the results of 4Q17.



We have now once again reported a double-digit operating growth, 12.5% in the consolidated results; 10.2% in the foreign market. In the domestic market we continue to observe a recovery in short cycle products, especially in agribusiness and consumption.

The long cycle products have a demand that is below expectations. The recognition of the revenues of an important solar energy projects has contributed to the growth of revenues in 4Q 17.

In the foreign market we observe growth in all regions for short cycle products. There is an increase in projects for long cycle in South America, the United States and Australasia. Additionally the consolidation of the new transformer business in the USA has helped us in consolidated revenues.

We also have an EBITDA margin of 14.1%. We attempted to preserve our margins and returns to guarantee or competitiveness and the long-term and this would have happened if not for impacts on our margins this quarter.

The first impact was in the US a transformer company, structural adjustments and the processes that we have been implementing since the acquisition that will offer better results for all 2018. This impacted his normal and considered during the time of acquisition.

There was another important impact in South Africa. The low performance of some projects, for example EPC, compromised our results for the quarter.

And the participation of new businesses, especially solar energy, has caused greater pressure. It is important to remember that this is a business that is still maturing. It has an attractive return on invested capital but lower operating margins. Were we to eliminate those results the margins of 2017 would be similar to 3Q 17.

The third highlight is the ROIC growth. We reached 15.4%, the best performance in the last eight years. These results are thanks to a better operating performance during the year and a very careful use of our capital.

**Return on invested capital (ROIC)**


We go on to slide number four where we have more information on the return on invested capital with the result of 1.7 p.p. vis-à-vis 2016. The growth of our operating profits after taxes results from a growth in revenues, the control of expenses and an improvement in the other non-operating accounts.

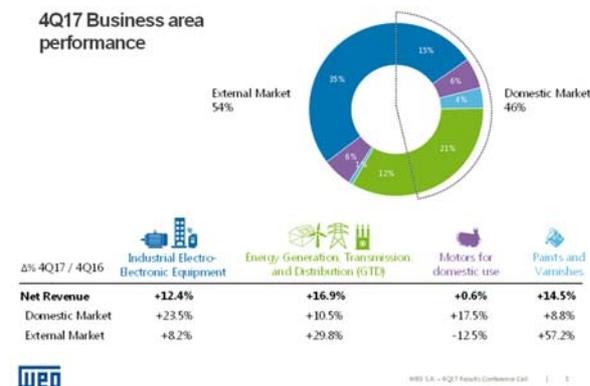
This has led to very good use of the capital employed that is necessary to allow for our growth. We needed more working capital and for the investments carried out in PP&E during 2017.

I would now like to give the floor to Mr. Polezi who will continue with the presentation.

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**Mr. Paulo Polezi** – Finance and Investor Relations  
Officer

Good morning to all of you. We go on to slide number five to show you the performance in the different business areas.



For the first time we observed a growth of revenues in all areas. In terms of electro electronic and industrial equipment a better demand in Brazil has been impacted by the short cycle products we are selling the OEMs, besides having clients that are now changing their obsolete engines with a view to improve the energy efficiency.

GTD had as a highlight its solar energy that became evermore important in 2017. We had two important solar farms as part of our portfolio. Part of the revenues were recognized in 2017 with a positive impact.

In motors for domestic use the combination of low inflation, low interest rates and an increase in consumption allow for a growth in several areas, especially in the durable goods, the white line, reinforcing our revenues for this quarter.

The performance of paints and varnishes continued the performance of consumption goods and industrial equipment with an intensification during the last quarter.

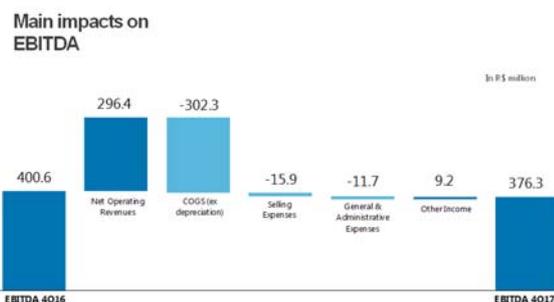
In the external market there has been a growth of revenues in all areas, except for motors for domestic use. We compare ourselves with a very strong quarter in 2016.

In industrial electronic and electrical equipment everything was given thrust to by the short cycle products, the construction of new plants and the demand for long cycle products are beginning to appear, especially in pulp and paper and infrastructure.

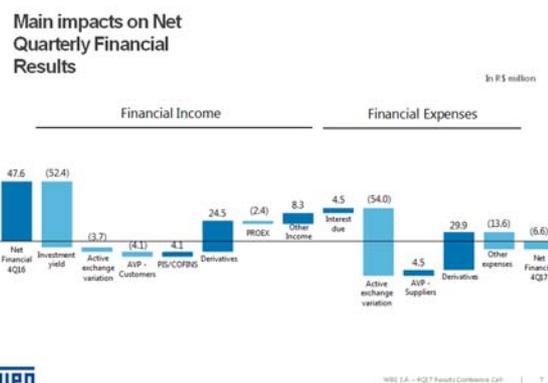
In GTD the growth of revenues was boosted by the new industry in the United States, WEG Transformers USA, contributing with revenues of 84.8 million during the quarter.

In paints and varnishes the increase in revenues reflects the search for new clients especially in Latin America with products that already are consolidated in Brazil.

As Andre mentioned we have a continuous focus on preserving our margins and returns to guarantee or competitiveness.



In slide number six you see the evolution of EBITDA in 4Q 17. The growth of costs was greater than the growth of revenues explained by what was already mentioned by Andre. EBITDA had the growth of 6.1% vis-à-vis 4Q 16 and we had a 14.1 EBITDA margin. It is important to highlight that were we to eliminate those effects the margins would be very similar to those we had in 3Q 17.



In slide number seven we show you our financial results, 6.6 million BRL negative. This result was impacted mainly by the lower interest rates that we observed throughout 4Q 17 as you can see in our yield chart.

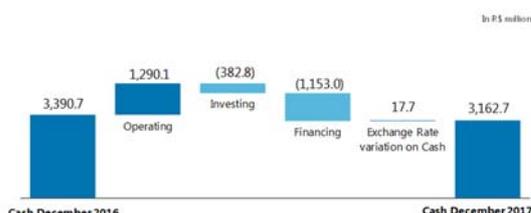
We also had an impact of 10 million BRL referring to the rates for the settlement of an old financing line with costs above the yield of our financial applications. This



work was done and we maximize our financial results in 2018.

Although the impact was negative financially the reduction of interests tends to be positive for the company business, as it reflects a more stable economic environment, a greater trend towards consumption and more industrial investment.

Main impacts on Cash Flow



In slide number eight we analyze our cash flow. Our cash flow generation reached 1,290 million BRL during the year in our operating activities. Cash generation despite this was below the results in 2016 because of the use of working capital in 2017. This is a natural procedure. Even with an increase in value we had an improvement in all of our items.

In investments we consumed 382.8 million for the quarter to optimize our productive capacity.

And finally financing activities consumed 1,153 million BRL during the period showing a greater flow of payment of dividends and also financings.

Capex Program Quarterly Evolution



Finally on slide number nine we show you our investments or Capex during the last quarter. In 4Q investments reached 75 million BRL, half of which devoted to the foreign market and half to the domestic market. We can see that the more normal behavior in the markets demands that we gradually increase our disbursements in increase of capacity. This is a positive trend and we hope that this will continue in the Brazilian market.

With this I would like conclude and I return the floor to Andre.

Outlook

The industrial recovery cycle continues in Brazil

- Recovery trend continues of short cycle products
- Combination of low inflation and lower interest rate brings good prospects for the business environment in Brazil
- Growth in order intake indicates better conditions for long cycle products in 2018

Abroad, signs of recovery

- Increasing industrial production in major global markets
- Improvement in short cycle products driven by OEMs
- Industries begin to demand long cycle products

Revenue and ROIC will be the main drivers for 2018

- Improved global industrial investment and new businesses are expected to boost revenue growth
- EBITDA margin may suffer volatility, impacted by recent acquisitions and higher mix of new businesses in revenue
- ROIC continues to be the company's main driver



Mr. André Luís Rodrigues – Managing Director Financial Superintendent

Thank you very much Paulo and before we go on to the question-and-answer session I would like to reinforce some points. Once again in Brazil the industrial recovery cycle continues, especially in the short cycle products.

A combination of low inflation, lower interest rates and with prospects for business should have an impact on the environment in coming months, which could reflect in no industrial investments and a growth in orders indicates better conditions for the long cycle products in the long-term.

Abroad the signs of recovery seem to be more consistent. Industrial production growth in the main global markets and the improvement in short cycle products is driven by OEMs. There are important industries that begin the demand long cycle products.

Finally the revenue growth and our focus on return on invested capital will be the main drivers for 2018. Revenues should increase because of the industrial



improvement worldwide and because of solar generation.

Good news to conclude: yesterday Cade by unanimity approved our acquisition of TGM, which is an important step in the growth of the group. This will bring about opportunities for new businesses in Brazil and abroad.

We can now go on to the question-and-answer session. Operator you may proceed.

you are feeling in terms of the behavior of this new financial metric you are sharing with us.

The second point refers to the bonus that was announced along with the results. It would be wonderful to hear from you why this movement was carried out, if you are simply trying to improve the profits of the company or if this boils down to a simple remuneration thank you.

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## Q&A Session

### Operator

Ladies and gentlemen we will now go on to the question-and-answer session. Once again we would like to remind you that this conference call will be conducted in Portuguese with simultaneous translation into English. Should you wish to pose a question please press star one and to remove your question from the queue star two.

The first question is from Lucas Marchiori from Safra Bank.

### Mr. Lucas Marchiori – Safra

Good morning and thank you for the call. Two important points. First you spoke about the return on invested capital and I think that it is important for the market to have this metric. I would like to know which is your view of the levels reported for the quarter compared to the mission of the company. As the economy resumes will this metric improve, decrease? Will it be a nominal value or a spread with the cost of capital? I would like to hear

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### Mr. André Luís Rodrigues – Managing Director Financial Superintendent

Hello Lucas this is Andre Rodrigues thank you for your questions. Let us speak about the return on invested capital and Salgado will speak about the bonus. Nowadays the ROIC is the main company indicator, it is how we measure management performance and in the last quarter of the year we had the best result of the last eight years for ROIC.

In 2017 we had anticipated that we would focus strongly on improving ROIC after two years of crisis. We maintained our resiliency and even in the worst moments of the crisis we maintained the figures of 2015; but 2017 was a year for improvement and we reached a growth of 1.7 p.p.

And the focus going forward is to improve and develop this indicator further. Of course this will depend on our business mix. At some point in time we may have to make investments that in the short term will have an impact and reduce the indicator. We can revert this quickly and we also have potential acquisitions abroad - but the focus continues to be the same and we are working towards improving the indicator.

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### Mr. André Salgueiro – Investor Relations Manager

This is Andre Salgueiro. In terms of the increase of capital according to the new law the profits reserve cannot go beyond the amount of the company's stock. Considering the forecast of results for the coming 12 months or perhaps a longer period we would be very close to overcoming shareholders equity and because of this we have some options: one was to pay out dividends and the other one was to increase shareholders equity, which is the option that was deliberated by the board of management.



This is a proposal that will have to be ratified at the shareholders assembly and we are going to instead of issuing new shares we are working with this bonus. We increased the number of shares and we increased the liquidity of our securities. This is an indirect effect that could also benefit the liquidity once it has been approved.

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**Mr. Lucas Marchiori** – Safra

Thank you very much.

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**Operator**

The next question comes from Mr. Noronha from send tender Bank.

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**Mr. Joao Noronha** – Santander

Good morning to all of you thank you for the question. I would like you to further explore your vision of the evolution of the impacts that have hampered your Ebitda margin in 4Q, how this will evolve throughout 2018. If you could give us more color and this I think it would be interesting.

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**Mr. André Luís Rodrigues** – Managing Director  
Financial Superintendent

thank you Joao. Let us speak about these impacts and how they happened. The first refers to the acquisition of WEG Transformers USA that took place in June last year. We had anticipated that the level of profitability would be below our expectations and this of course was considered in the price.

And now WEG along with the operation in Mexico will have very interesting and synergic opportunities and we are trying to develop the commercial and operational aspect to increase the profitability of this business. Throughout this year we hope to improve this and to be very concrete in 2Q this is the quarter where we will be able to revert the situation of a deficit and through time what we expect is to allow profitability to reach the profitability that we have other transformer unit in Brazil and abroad.

We are being very objective. This has been carefully measured; the action plan has been developed. We have a team of Brazilians that remain one month in Mexico with specific goals to be able to reverse the situation and we are very confident that we will be able to leave this deficit behind us.

In South Africa perhaps we should understand the business environment for WEG and that the country. Between the marketing of electrical motors and electro electronic components we also set up automation panels, transformers, substations and an industrial electrical installation of average and large size. We work with this in South Africa.

In LQ 17 we had an increase in costs that was not expected in some of the projects, especially in EPC and the automated panels, because of their characteristics. We are very large, they are very complex and because of the geographical location in sub-Saharan Africa.

Which are the measures we have taken so that this would be a one-time event? This was an unexpected event in the projects. We carried out a scan to avoid the recurrence of this problem and additionally this impact was concentrated on the more relevant and more complex projects. This is not a characteristic of the other projects that are being developed.

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**Operator**

The next question is from Felipe.

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**Mr. Felipe Vinagre** – Credit Suisse

Good morning to all of you. I have two questions, the first refers to solar energy. You have this new endeavor that seems to be becoming stronger. If you could compare this with the beginning of the wind farms which are the differences in these two large markets that are very recent markets for you?

Do you think that solar energy has a better foundation than the wind power? How would you compare the ROIC and the margins and of which were the scenarios for these two markets for 2018 and 2019 if we keep in mind at the auctions? This is only my first question and I will then ask the second one.



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**Mr. André Salgueiro** – Investor Relations Manager

Felipe good morning this is Andre Salgueiro I will speak about solar energy and I would like you to confirm the backlog for solar energy?

Solar energy is something relatively new for WEG and not only in Brazil; it is something that is gaining movement in the last few years. Comparing this with wind power the great difference is that we are going into a period that is previous to the cycle. When we decided to enter this the main players were already in Brazil and WEG had to come up to parts.

With wind power we worked on substations, transformers, the inverters and all of this was part of our portfolio. What we have done in the last year was to have more services and offer a full package to the clients. It is a new market that is growing in Brazil has an enormous potential for this.

We have mentioned this before. In the worst place of solar radiation it is 30% better compared to Germany when it comes to solar farms.

And what about the generation in Brazil? What do we have in terms of generation? We have the wind power that is practically stable vis-à-vis 2017 and the projects we had in backlog. The level of revenues was 700 million last year and we should see this again in 2018.

We still do not have any visibility about projects for 2019. We are looking for these opportunities in the market, we have no projects in our portfolio for 2019.

And for solar farms we have the projects announced in the last quarter, the projects of Coremas with 400 million BRL. Part of this project came into operation in LQ 17 and the rest will come into operation in 2018, and other projects that up to 250 million BRL.

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**Mr. Felipe Vinagre** – Credit Suisse

Very good. My second question is on the evolution of the loss of price and commodities. Are there new opportunities for projects, new revenue opportunities because of the commodities?

And in the short term will this have an impact on 4Q and if this is the context what will happen with the price

transfers especially in the foreign market where your leadership position tends to be lesser then in Brazil?

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**Mr. Paulo Polezi** – Finance and Investor Relations Officer

Felipe this is Paulo Polezi good morning. When it comes to the commodities and their impact and what happens with our business I am going to respond to this in parts. In the domestic market a very minor impact. We still have not observed the impacts that take place additionally in mining, oil and gas, which are traditional segments for WEG. We still do not see her reflection or improvement and this is what we have mentioned in our releases.

On the other hand we begin to see more mature markets. In our European operations there is an entry of orders that seems to be more consistent and clients that are traditionally from these sectors that made maintenance orders only are now placing orders for more complex and larger products. This is what we have observed in the more mature countries.

Another highlight moves away a bit from commodities and this part of the long cycle and it refers to China. China's fostering an important expansion program in infrastructure, the One Belt One Road Program that is very well known and we feel that there is an improvement, a significant improvement.

Another economy where we have enhanced our position for long cycle commodities is India. We have observed improvement there as well, which means that gradually the conditions are improving and all of this driven by the improvement in the price of commodities.

We should remember nevertheless that this effect extends to everybody, to wag and to our competitors. We do not manage the prices, we do not control them; high commodities are good for short cycle and what we observe now should be the trend going forward.

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**Mr. Felipe Vinagre** – Credit Suisse

Thank you, thank you very much.

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**Operator**

The next question comes from Alexandre Falcao, HSBC.



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**Mr. Alexandre Falcão – HSBC**

Good morning to all of you. I have two questions, the first refers to your cash and your ROIC. Is there something else that you can do to revert what you are doing? I am imagining your levels of EBITDA and Capex?

The second question refers more specifically to Brazil. Which is the indicator that you believe we are going to see more when it comes to the short cycle and long cycle products? Thank you very much.

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**Mr. André Luís Rodrigues – Managing Director  
Financial Superintendent**

Hello Falcao. Referring to our cash situation we tend to say that our financial flexibility is one of the foundations of our business model, because we are able to invest in opportunities arise regardless of the economic situation. In the last years we have preserved our liquidity and our strength. We made sure to preserve our cash position.

It is normal to say that now that we have a more normal market we will once again explore growth possibilities, both organic and non-organic maintaining our flexibility and any surplus cash doubtlessly will be paid out to the shareholders, especially if it goes beyond the levels that are normal at WEG.

Now your question about having an indicator we follow industrial production and growth, the growth of the economy. This is what is going to determine what will happen with these two previous points, what will happen in the near future. Now I would like to remind you that for short cycle, and we have always said this, we can see this in a more consistent way not only in Brazil but in the rest of the world as well.

The order impact for short cycle we are more consistent sales. We always spoke that we needed to recover maintenance to then be able to make investments in greenfield. In Brazil we see that there is a recovery in maintenance. Clients are trying to invest in energy efficiency, and this is improving the short cycle scenario.

In long cycle in the case of Brazil we need to have more patience. Due to the crisis that Brazil faces it is natural that the short cycle be the first, and it will bring up the situation of the long cycle. When we are speaking about long cycle we have had an order intake that was more positive than the last quarter, and the prices of

commodity are one of the indicators of the global situation as Paulo mentioned, and this will have a positive reflects for WEG, it will lead to a price increase and so on.

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**Mr. Alexandre Falcão – HSBC**

Thank you very much. I would like to know if you are planning on making some change in the United States, if you could do for example what is done in the United States in terms of the billing or invoicing. I believe that was a question.

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**Mr. Paulo Polezi – Finance and Investor Relations  
Officer**

This is Paulo Polezi. Your question refers to the recent reduction of aliquote in the United States that went from 34 to 21%.

What do we have in terms of an update? We are following very closely on what is happening. Now this change is quite recent and we need to carefully analyze it before taking any action. When I can say is that we have been involved in this. We have specialized consultants that are working on this and we hope to conclude this work in midyear. On that day we will be able to offer you an update on the impact of this.

At this point in time I can say the following: from what we have seen we have received Falcao that this benefit will not be integral, it will not represent 21% fully because there are several alterations when it comes to the calculation of income tax.

We believe that for most of the companies the aliquote will be between 21 and 34; but I do not think it will remain at 21% because there are other alterations that will be included. Perhaps in the coming quarter we will be able to give you a clearer update on the impact for WEG and the measures the company will adopt.

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**Mr. Alexandre Falcão – HSBC**

Thank you very much.



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**Operator**

Ladies and gentlemen we would like to remind you that should you wish to ask a question please press star one. Once again should you wish to pose a question please press star one.

The next question is from Marcelo Silva.

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**Mr. Marcelo Silva – Gaspak**

Good morning. About news that was printed in the Estadão yesterday about the shares I would like to know if there is any impact on the company.

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**Mr. André Luís Rodrigues – Managing Director  
Financial Superintendent**

Hello Marcelo. This is something that pertains to the holding company and will have no impact on our operations.

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**Mr. Marcelo Silva – Gaspak**

Thank you.

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**Operator**

If you wish to pose a question please press star one.

The next question is from Alexandre Falcao from HSBC.

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**Mr. Alexandre Falcão – HSBC**

Thank you for the follow-up. What can we think about going forward? What are you going to do with your budget? As you are beginning with solar energy if this will have a negative impact on your return on invested capital simply to gain a better understanding of what you are thinking in terms of ROIC thank you.

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**Mr. André Salgueiro – Investor Relations  
Manager**

Falcao this is Andre Salgueiro. The ROIC metric has been disclosed for some time and it is that the level of 15 or 17%. Some years we have fallen below that, especially in years of crises. We do not have a long-term metric; but the target for 2018 and 2019 is to remain at that level perhaps with a slight increase.

When it comes to your comments, an important issue wind power and solar energy oftentimes end up causing pressure on our EBITDA margin. We work based on the model of an integrator where we produce part of the equipment, we add services but we also purchase equipment from third parties. This causes pressure on our EBITDA margin; but our ROIC tends to be similar or somewhat better than other activities. This should not cause any pressure on the ROIC, perhaps some minor pressure on the EBITDA margin.

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**Mr. Alexandre Falcão – HSBC**

If you allow me to ask the last question about what you are doing in China and Mexico. At what level are you presently and when we began you mentioned that you had a very good capacity in China, that you were creating a critical mass there.

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**Mr. André Luís Rodrigues – Managing Director  
Financial Superintendent**

Falcao let us begin with Mexico. In Mexico we are making investments in the last stage of verticalization foreseen of the present. This is a project that should end by the end of this year; and then Mexico will be able to produce its own purposes and will have a full verticalization process in this cycle. Subsequently we will be planning minor expansions depending on the market in Mexico and in the USA.

In China going forward the investment was made and it doubled the production capacity of WEG motors and at the end of 2015, beginning of 16 this increase of capacity has been fully consumed. Plants are operating at full capacity and now we will continue to invest in capacity increases, more on a one-time basis. If one day we observe the need of having a special foundry for China we would make that additional investment as well.

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**Mr. Alexandre Falcão** – HSBC

Thank you very much.

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**Operator**

At this point in time the question-and-answer session ends here. I would like to return the floor to Mr. Andre Rodrigues for his closing remarks. You may proceed sir.

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**Mr. André Luís Rodrigues** – Managing Director  
Financial Superintendent

Once again thank you very much to all and until our next meeting when we will speak about the results of 1Q TY, I hope to see you soon.

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**Operator**

The conference call for WEG ends here. We would like to thank all of you for your participation and have a good day.

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