WEG S.A.
1st Quarter 2018 Earnings Results Conference Call
April 19, 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. Wilson Watzko** – Controller Officer

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

## PRESENTATION

**Operator:** Good morning and welcome to the conference call of WEG about the results of 1Q 18.


We inform that this conference call and the accompanying slides are being transmitted on our website of investor relations at ir.weg.net and after its completion the audio will be available at our website of investor relations. Should you need assistance during this call please request the help of an operator by pressing star zero.


Any forecasts contained in this document or statements that may be made during this conference call relating to WEG's business prospects, projections and operating and financial goals and to WEG's potential future growth are based on management's believes and expectations, as well as on information that is currently available. These statements involve risks, uncertainties and the use of assumptions as they relate to future events and dependent circumstances that may or may not occur.

Investors should understand that general economic conditions, conditions in the industry and other operating factors may affect WEG's future performance and lead to results that may differ materially from those expressed in such future considerations. We would like to remind you that this call is being held in Portuguese with simultaneous translation into English.

Here with us we have Andre Luis Rodrigues, CFO; Paulo Polezi, Finance and Investor Relations Officer; Wilson Watzko, Controller; Andre Salgueiro, Investor Relations Manager.

Please Mr. Andre Rodrigues you may continue.

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

Good morning everyone. It is a pleasure to be with you again for the teleconference to present the results of 1Q 18.


I would like to start by highlighting the main points of this quarter. First we had strong revenue growth, 19.6% in the consolidated results of which 13.9% in the domestic market and 24.5 abroad.

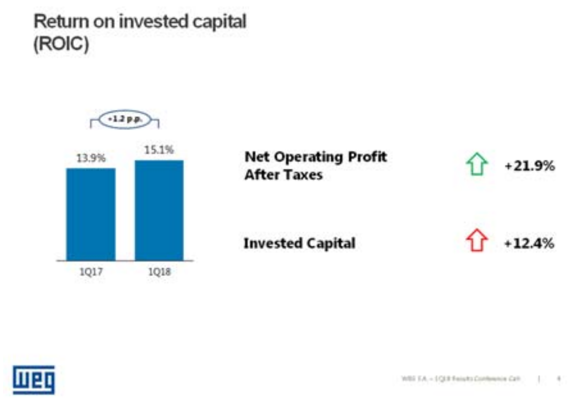
In the domestic market this growth was driven by the economy recovery and the increase in share of the business of solar generation plants. It is worth mentioning that as of March after the final approval of Cade, Brazil's antitrust agency, we started to consolidate TGM, a steam turbine company acquired in December 2016, which contributed to our portfolio of GTD products.

In the international market growth remains concentrated in sales of short cycle equipment; but we have already found some opportunities in major projects of industries that require long cycle equipment.

In addition the consolidation of the new business of transformers in the United States helped in revenue growth.

Second the performance of the EBITDA margin was as expected showing improvement over 4Q 17, since the one of the impacts of the last quarter and no longer present; but stayed below 1Q 17 margin impacted by the acquisition of the transformers operation in the United States and by the rapid growth of the solar generation business, still maturing and with lower operating margins.

Finally I would like to highlight again the generation of cash from operations, which reached 492.6 million and the growth of return on invested capital in the annual comparison, the main performance indicator of WEG.

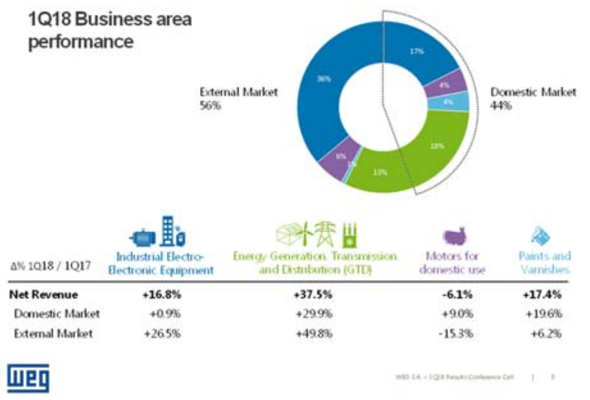



Going to slide number four we have more details of ROIC, which grew by 1.2 p.p. when compared to 1Q 17 reaching 15.1%. The growth in operating income after taxes is due to the revenue growth, improving and operational performance and other nonoperational accounts. This growth more than offsets the growth of capital invested required to support business growth; but both from recent acquisitions and investments in working capital, fixed assets and intangible assets carried out over the last 12 months.

I now turn the floor over to Paulo Polezi.

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

Good morning everyone. Moving on to slide five we present the evolution of the business areas in the various markets. In the domestic market we had the growth in all business areas.




In the area of industrial electro electronic equipment after last year's recovery we reached a standard level for a short cycle products, especially low voltage motors and serial automation equipment, which presented lower growth in sales QoQ.

The solar generation business with a highlight in GTD gaining relevance in recent months, with two major solar projects added to the portfolio and contributing positively to revenue growth this quarter.

Additionally as already mentioned by Andre since March we are consolidated the operation of TGM in this business area.

In motors for domestic use the current dynamics of last quarters continues, favored by the combination of increased consumer confidence, low inflation and lower interest rates.

The performance of paint and varnishes reflected the performance of industrial and consumer goods markets, which have intensified the recovery process over the past quarters.

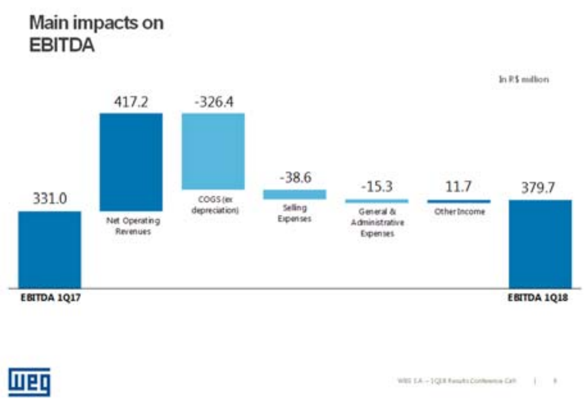
Internationally we also had revenue growth in all areas, with the exception of motors for the domestic use, where the effect of component inventory adjustments in large global OEMs and the decrease in orders coming from China have impacted performance in this quarter.

In electro electronic equipment growth remains driven by short cycle products in countries in Europe, Asia and Africa have shown significant growth in revenue this quarter.

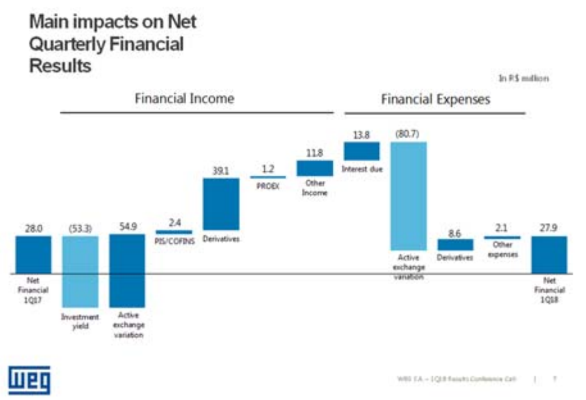
In addition capacity building projects and the construction of new factories, which also demand a long cycle products, continue to grow mainly in industries relating to mining, infrastructure and production of pulp and paper.

In the GTD area revenue growth was driven mainly by the consolidation of the new US transformers company.

In paint and varnishes the growth in revenue in the international market reflects the search for new customers especially in Latin America, with products already consolidated in Brazil.

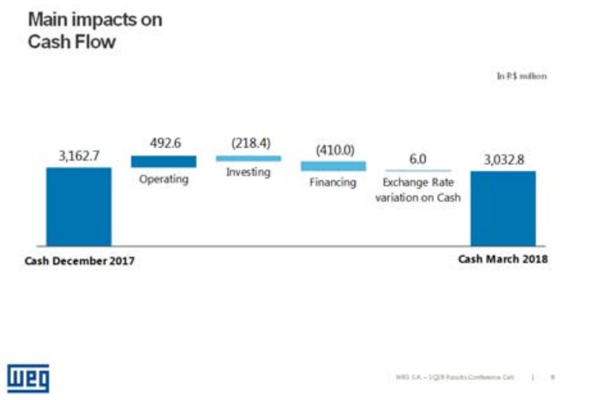



On slide six we see the evolution of EBITDA in 1Q 18, in which the main highlights when comparing to the quarters was the growth of revenue: EBITDA grew 14.7% in relation to 1Q 17 and there was a reduction of EBITDA margin to 14.9%. As Andre mentioned this performance was within our expectations and EBITDA margin recovery will happen naturally with the integration of new acquisitions and as the new business in GTD matures.




Slide seven shows the net financial result in the details, which reached 27.9 million BRL positive remaining stable when compared to 1Q 17. In this quarter we recognized interest revenue on contract renegotiations with clients, which offset the lower interest rates received on our cash position.

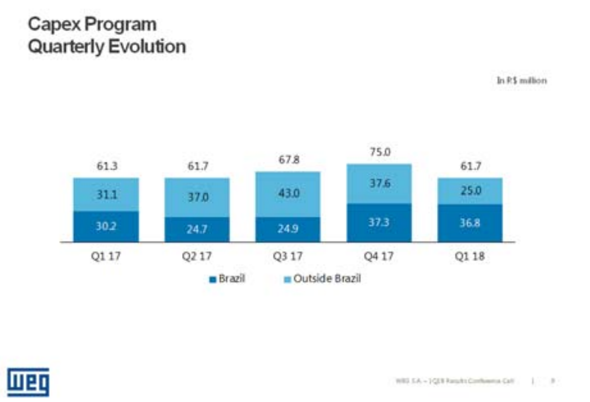
It is worth noting that despite the negative impact on our financial results the reduction in interest rates is very positive for the company's business, as it reflects a more stable economic environment with an increase in consumption and consequently higher level of industrial investment.




On slide eight we have the cash flow analysis. Cash generation from operations reached 492.6 million BRL in the quarter, an increase of 18% compared to the same period of the previous year resulting from a better operational performance in conjunction with working capital management.

Investment activities consumed 218.4 million BRL in the quarter, reflecting a stable level of investment when compared to 1Q 17 and considering the acquisition of TGM as well.

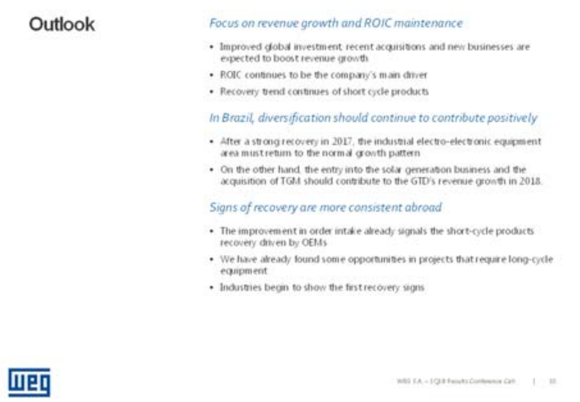
Finally financing activities consumed 410 million BRL in the period reflecting the increased settlement of loans and the greater payment of dividends in the quarter.




Finally slide nine shows the investments of the last quarters. In 1Q 18 investments totaled 61.7 million BRL, of which 60% went to Brazil and 40% to production units abroad. It is worth mentioning that the normalization of market behavior requires that we gradually increase disbursements for the modernization of our production capacity and purchase of machinery and equipment in Brazil.

For the first time in the last twelve quarters investment in Brazil was higher than overseas.

With that I finished my presentation and return the floor to Andre.




---

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

Thank you very much Paulo. Before I start the Q&A session I want to reinforce some points. First, as anticipated in 4Q release growth revenue and the continuous focus on ROIC will be the main drivers for 2018.

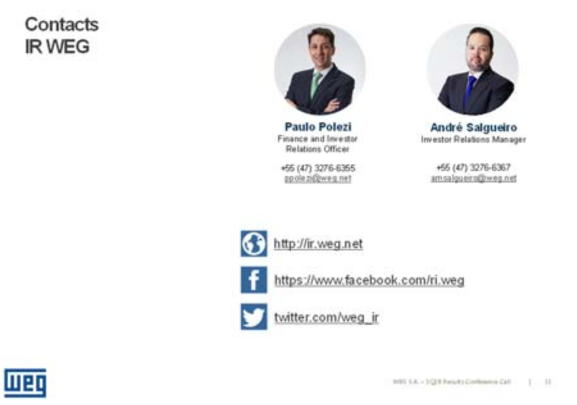
Revenue should grow organically with increasing global industrial investment, with the entry into new businesses such as solar generation and with acquisitions that increase our competitive advantage, such as the recent acquisition of US Transformers operation for example.

In Brazil the diversification of our business will continue its positive contribution to our revenue growth. After the recovery in 2017 of the area of industrial electro electronic equipment in 2018 we have the solar generation business and TGM contributing to GTD revenue growth.

In the international market the signs of recovery are more consistent: industrial production rose the main global markets and the improvement in short cycle products continues to be driven by OEMs. In addition important industries are beginning to show the first signs of recovery, with the emergence of the first opportunities of products involving long cycle equipment.

To conclude I would like to highlight that this morning we sent the save-the-date for WEG Day 2018. This year the event will be held in two days: June 12 in New York and June 20 and June 22 in Jaragua do Sul. We will be pleased to see you in one of our events.

We can now start the Q&A session, operator you can continue.




---

## Q&A Session

### Operator

Ladies and gentlemen we will now start the Q&A session to ask a question please press star one and to remove your question from the list please press star two.

Our first question comes from Lucas Marchiori from Banco Safra.

---

**Mr. Lucas Marchiori** – Safra

Good morning everyone thank you for the call. The first question about solar energy: could you specify from a solar complex, which equipment do you provide? Is that the transmission system? What type of equipment and what percentage of Capex of a solar plant does WEG account for in terms of the potential of equipment provided by WEG? Just for us to have that figure in mind.

And the second question something that Paulo mentioned called my attention: the fact that 60% of investments were made in Brazil after a long period that you invested more abroad; and also the nominal drop in Capex abroad.

I would like to understand how we should interpret that; if you plant them maybe grow that in other geographies? If you could just explore that a little bit more, thank you.

---

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

Hello Lucas thank you for the question this is Andre Salgueiro speaking. I will answer the solar question and then Paulo will talk about Capex.

As for solar we started selling equipment to the solar energy market. The main is the frequency inverter but we also have solutions of substation and transformers for solar complex, for solar plants. Some new accounts in our portfolio that joined our portfolio recently we sold the entire… We started to operate as a turnkey provider since August and so we develop equipment sold by WEG; we buy the rest which we do not make, which is solar panels for example; and we deliver the full package to customers.

So these two major projects that we are recognizing the revenue this year we are billing 100% of the project, including the parts that are purchased from other providers; but if the customer wants we can only sell part of equipment such as the frequency inverters or substations and transformers.

---

**Mr. Lucas Marchiori** – Safra

These components, these inverters and transformers how much do they account for a Capex of a solar plant?

---

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

Well we believe it is about 45% equipment and services from WEG and 55% from other providers, this is pretty much the breakdown.

---

**Mr. Lucas Marchiori** – Safra

Okay thank you.

---

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

Lucas good morning. Continuing with the question about Capex yes, after a long period of many quarters this year the Capex is more local after a long period of investments abroad. So this year we estimate to invest 370 million. Of course it may be a little bit lower, this is a goal of Capex investment and it may be a bit lower than that; but the main reason is the end of a cycle of investments in Mexico and China. In China investments have been completed last year, the plant is producing at a full stage, at full capacity almost.

And in Mexico we had two stages of investment: first to increase the production capacity of the plant, which was completed; and the other investment was significant or even more significant, was another project that ends at the end of this quarter, of this year I am sorry. But we still have some investment, about 20% of this budget will be invested still in Mexico.

But the most capital intensive investment abroad ends this year with Mexico and from now on we will see where the market goes and WEG wants to invest to increase productivity and make the most of all opportunities available.

---

**Mr. Lucas Marchiori** – Safra

Okay thank you.

---

**Operator**

The next question comes from Joao Noronha from Santander.

---

**Mr. Joao Noronha** – Santander

Good morning everyone thank you for the question. I have two questions, first regarding margins. I remember that in discussions in 2017 the main message was that you were developing margin every quarter, it was running close to 16%.

And now looking at the scenario for 2018 and considering the deliveries it is complex to think about the company going back to reaching 16%. How do you see the development of margin quarter on quarter for 2018?

And the second question if you could give some more color about the closing of projects and sales as of April 2017.

---

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

Hello Joao this is Andre Salgueiro speaking. In terms of margin what they have mentioned since last quarter of 2017 is that the consolidated margin for 2018 should stay at a very close level of the consolidated margin of 2017, which closed at 15.5%.

We also said that given the higher concentration of solar project deliveries in 1H TY and also the impact of US Transformers operation on the results, and since we expect to improve the profitability of this operation throughout the year, it is natural to forecast that 1H TY we have a margin that is a bit lower than that level and a slight recovery in 3Q TY and 4Q TY.

As you know the company well we have a wide variety of businesses and so these estimates are based on the figures that we have right now.

---

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

Good morning Joao this is Paulo speaking. I would like to give you an update on research and development or T&D. We had three transmission auctions: 12 billion in October 2016 and other 13 billion in April 2017 and then in December 2017 9 billion BRL.

So our vision is that all the auctions were very successful and they brought new players to the process, which brings us a good business prospects, for everyone actually. We are very confident and we are working on the market looking for new orders. WEG is a ready participating in contracts for substations and we continue focused on obtaining new orders on our transformers as well.

But even without any new pre-agreements - we had the big one and then we did not get any one - but even without these new pre-contracts that are still players in the market that have not yet signed this precontract with anyone, so there is to opportunities available in the market and we are going after them.

Also we are working on other fronts such as selling equipment directly to those who won the auctions, which provides us good business opportunities as well as selling to other providers in all the lots.

So it is a long process. We know it takes longer because projects will become effective in coming years - but they are happening quite intensively I would say.

---

**Mr. Joao Noronha** – Santander

Okay thank you very much.

---

**Operator**

The next question is in English from Juan Tavarez.

---

**Mr. Juan Tavarez** – Citi

Hi thank you and good morning everyone. My first question is just to touch little bit on your new businesses that you mentioned that are in the early stages. I am curious what would be impact on your margins and your ROIC today if these segments were operating with normalized possibilities? Would there be an expansion of 50 bps on our margin in ROIC? And also when would you expect these projects to reach those normalized levels?

And my second question just touching on GTD is what is the size of your backlog for wind? Because I thought you mentioned that those sales for those projects are likely going to end in 3Q TY and also what is the size of your backlog in solar? And maybe putting that in context of how different is the visibility of your backlog today within the GTD business versus what it was either this time last year or even in the last quarter? Thank you.

---

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

Hi Juan this is Andre Rodrigues speaking. We will answer in Portuguese but then there is simultaneous translation to clearly explain to you in English.

So as for the acquisition of WEG Transformers in the United States your question was how would be the margin of WEG in this quarter excluding the impact from solar, WTU? Well it would be slightly higher than we had in 1Q LY.

I think I will take this opportunity and so before talking about how we expect to improve it is to say what we have been doing since the acquisition process that happened in 3Q LY.

We optimized industrial processes using the synergy with the Mexican unit and whenever I had the chance of talking about the acquisition I said that it is a very strategic acquisition given the opportunities of synergy with Mexico.

And today we are actually producing some components in a Mexico to optimize costs, and we also developed a single supply chain management, which allows us to make annual purchases of packages and single prices for raw materials that are used in common and that has been implemented.

We also defined the adequate portfolio of products for each industrial plant; what needs more optimization is made in Mexico and what should be done in the US, this is ready; and we also made some changes in the organizational structure of the company.

We expect that in 2Q TY, so now, we will be able to present positive operational results. This is what we are focused on now and we expect this yes to happen in 2Q TY.

---

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

Juan as for your second question about backlog we do not usually give this guidance on backlog for every quarter; the backlog for the revenues of wind power this year will be at the same level of last year pretty much, 700 million BRL, and these 700 million BRL will be distributed linearly throughout the year. So based on that you can have idea of what the revenue from 1Q was and what we estimate for the coming quarters of the year.

As for solar specifically what we have for 2018 total for the year, 500 million BRL, in solar we do have a greater concentration in 1H; 100 million BRL in 1Q and the second part will be in 2Q and 3Q and in 4Q with will be a little bit lower.

---

**Operator**

Ladies and gentlemen we remind you that to ask a question please press star one. Once again if you have a question please press star one.

There is another question in English from Juan Tavarez.

---

**Mr. Juan Tavarez** – Citi

Thank you. Sorry just two more questions if I may, the first on tax management. I noticed that this quarter you had one of the lowest cash taxes that you have had in a long time, which helps you are ROIC; I am curious if this is the level that we should be seeing for the coming quarters as well or is there anything specific that you are able to monetize on your tax asset side that is facilitating these lower cash tax levels?

And second maybe just to touch on short cycle. You mentioned that in Brazil you have reached a normalized pace of demand for short cycle products. So is this segment back to precrisis levels now in Brazil? And maybe on the long cycle how would you categorize the gap today versus precrisis levels? Thank you.

---

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

Hi Juan this is Paulo speaking. You questioned about taxes. Okay, today the tax rate in 1Q was 13.8% and the same rate was 11.5% 1Q 17, so the levels are close.

What we can say for the future in terms of tax rate is that we believe it will be around 10% to 15% based on the three main benefits that the company obtains: first paying interest on equity which is still in force and that helps; there is also the difference of tax rate in operations abroad, which also helps; and finally the incentives, tax incentives for Lei do Bem, which gives donations. So with these three benefits we believe that the tax rate will be from 10% to 15% for the next periods.

The second question about industrial equipment and the behavior now has been normalized. Yes in fact we may say that yes, we have noticed a return to precrisis activities so to speak; but Juan for short cycle equipment, for low voltage motors, automation and serial equipment we can say with some comfort that yes, we have returned to precrisis levels.

What is still lagging or lacking is new orders for long cycle, because in Brazil we have not seen anything yet for that.

But in the external market we export a lot right? From our Brazil operations and we have seen some orders in small invoices for long cycle.

So in summary short cycle yes, we back to levels of precrisis; but in long cycle know.

---

**Mr. Juan Tavarez** – Citi

Paulo just to clarify one thing on the tax side. I was actually talking more about cash taxes that you report in your cash flow statement and not so much the reported tax in your income statement, where in the cash taxes where I saw that it is almost half the level of your reported tax, which was really low compared to even previous quarters.

So I am curious if there is anything in terms of how we should be looking at a monetization of some tax assets that you have on the balance sheet or anything like that that should facilitate or lower cash tax in the coming quarters; not so much the reported tax line, but more about the cash tax on your in your cash flow statement, which is in the end what impacts your ROIC in total. So I am curious if you have any guidance on that side.

---

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

Just a second Juan, please hold. Juan we have the numbers here with us. We do not see a material difference in numbers. I do not know exactly what you are referring to; but in a way we prefer to talk to you shortly afterwards and we can address this question in detail - but however we have not noticed any higher taxes in our cash flow. But we can get into more detail with you shortly after this call okay?

---

**Mr. Juan Tavarez** – Citi

Thank you very much.

---

**Operator**

The next question comes from Lucas Marchiori from Banco Safra.

---

**Mr. Lucas Marchiori** – Safra

Hello. It is a quick question from my side. You said that solar comes as a percentage of completion. These two major projects that now you have in your portfolio, how much of them have you made, that are realized so that we know how much more is to go?

---

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

Hello Lucas. I just mentioned this before; but we do not give details about this. But just for you to have an idea we have billed slightly above 100 million BRL this quarter for solar projects. So in the backlog of 500 for the total of the year this is what we have done so far up to March.

---

**Mr. Lucas Marchiori** – Safra

Okay thank you Andre.

---

**Operator**

Ladies and gentlemen I would like to remind you that in order to ask a question please press star one.

This ends the Q&A session. I would now like to turn the floor over to Mr. Andre Rodrigues for his final comments. Mr. Andre you may proceed.

---

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

Well once again thank you very much for attending the call. There are some questions sent via webcast and that will be answered by e-mail throughout the day. So see you in the next call, thank you very much.

---

**Operator**

The conference call of WEG has now ended. We thank you very much for attending and have a good day.

---