

WEG S.A.

4th Quarter 2018 Earnings Results Conference Call

February 21, 2019 – 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
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PRESENTATION

Operator: Good morning and welcome to this audio conference on WEG's earnings of 4Q 18.



We are broadcasting this conference call together with slides on our investor relations website at ri.com.net and after the conclusion the audio is going to be available on the IR website. If you need assistance during the conference call please reach the operator by pressing star zero.

DISCLAIMER

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The financial statements presented in this document have been prepared in accordance with IFRS (International Financial Reporting Standards). The financial information relating to WEG correspond to the company's consolidation information.

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The information denominated EBITDA – Earnings Before Interest, Taxes on Income and Social Contribution on Net Income, Depreciation, and Amortization, EBIT – Earnings Before Interest and Income Taxes and Social Contribution on Net Income are presented in accordance with Instruction No.527 issued by CVM on October 4, 2012.

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Investors should understand that general economic conditions, industry conditions and other operating factors may affect the future performance of WEG and delete to results that will be materially different from those in the forward-looking statements. I would like to remind you that the conference call is being made in Portuguese with simultaneous translation into English.

With us today in Jaraguá do Sul are André Luís Rodrigues, Chief Financial Administrative Officer; Paulo Polezi, Finance and Investor Relations Officer; Wilson Watzko, Controller and André Salgueiro, Investor Relations Manager at WEG.

Please Mr. André Rodrigues you may proceed.



Mr. André Luís Rodrigues – Managing Director
Financial Superintendent

Good morning everyone. It is a pleasure to be here once again truly is our earnings of 4Q 18.



Before starting with the highlights of the quarter on slide three I would like to remind you that in the beginning of 18 we said the growth of revenue and continuous focus on ROIC would be the main drivers for the year. With the numbers presented we see we have accomplished our objective.

Talking about the highlights of the quarter net operating revenue grew by 16.9% in 4Q, closing the year with growth of 25.7%. Paulo is going to provide more details on the performance around the presentation, and ROIC reached 17.6% going to levels observed only before the global crisis of 2009.

Other two highlights in the quarter were the growth of 30% of EBITDA that reached 490 million BRL with margin growing 1.6 p.p. reaching 15.7%, and the increase in the pace of investments totaling BRL 170 million in the quarter, including 60% of investments that were made in industrial complexes and other facilities overseas.



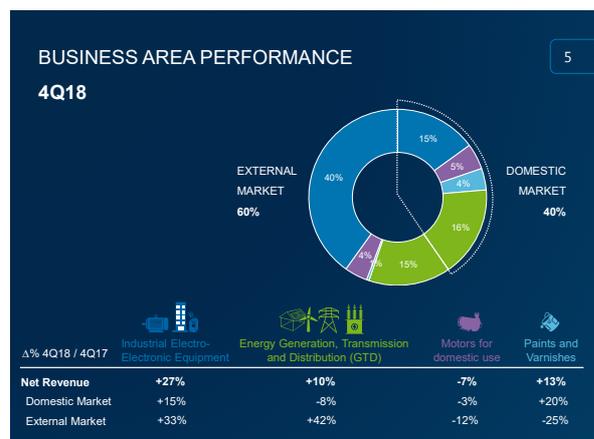
Going to slide number four we have more details on ROIC, who had the growth of 1 percentage point compared to 4Q 17 reaching 17.6%.

The best performance of operating profit after taxes is explained by the growth in revenue and improvement in operating performance. This growth more than offset the more capital invested necessary to support business growth, both because of recent acquisitions and for investments in working capital, fixed and the intangible assets performed along the year.

The consistency of this indicator proves our strategy to develop new businesses like wind and solar that although have margins structurally lower, presented attractive returns on capital invested. Now I am going to turn the call to Paulo Polezi.

Mr. Paulo Polezi – Finance and Investor Relations
Officer

Good morning everyone. Going to slide number five we show the evolution of our business areas in the different markets.



I will start with industrial electro electronic equipment in Brazil, where sales of short cycle equipment continued with the trend of growth.

Additionally in this quarter we observed growth of revenue of long cycle equipment, especially automation panels. We also observed an increase in the search for equipment to expense products, capacity expansion projects like brownfield; and new investments, greenfield, most of them already being processed but already signing for the beginning of a resumption of these projects in Brazil.

GTD had a drop in revenue this quarter in Brazil. The last projects of wind generation in the portfolio are already been concluded and already recorded lower revenue along 4Q 18.

Additionally transmission and distribution always contributed to a lower revenue in the quarter, showing, oscillating in the delivery of projects in the quarter.

On the other hand the solar generation continues to stand out and the prospects for the business continue positive, especially in distributed solar generation that has been showing continuous growth with our backlog in recent months.

In domestic use motors there was a small reduction in revenue, a reflex of the consumption dynamics in Brazil for this segment that did not present consistent recovery compared to last year.

The performance of the paints business reflected the performance of the industrial markets in Brazil that started to recover in recent quarters.

Overseas electro electronic equipment continued to grow, mainly driven by short cycle products.

As mentioned in previous quarters we have already observed projects to increase capacity and build new plants that also demand long cycle products, especially in industries connected to oil and gas, pulp and paper and mining.

GTD the greatest contribution comes from the transformers business that has growth in all operations abroad, particularly for the consolidation of the new transformers company in the US.

In domestic use motors in revenue has dropped especially because of a lower backlog in the local market in China, allied to a poor performance of the operation in Argentina that is suffering from the recent problems that are being faced by the local economy.

In paints the drop of revenue in the external market also reflects difficulties in the Argentinian economic scenario, one of the main markets for this business unit outside Brazil.



On slide six we have the evolution of EBITDA in 4Q 18. The major highlight QoQ was growth in revenues. EBITDA grew 30.2% compared to 4Q 17. As Andre mentioned, EBITDA margin closed the quarter and 15.7%, an increase of 1.6 p.p. compared to 4Q 17. This is a reflects of the better profitability and overseas operations, gains of margins in some operations in Brazil in addition to a lower revenue of wind generation that has traditionally lower operating margins.

Finally the lower exchange volatility in the period contributed for the stability of costs of raw materials in long cycle projects in Brazil.



Finally, on slide seven we show investments in recent quarters. In 4Q 18 investments reached 170 million BRL, 40% allocated to Brazil and 60% to production units overseas, showing significant growth compared to previous quarters especially because of in advance in investments in the first foundry outside Brazil of WEG that is being built in Mexico and that in this quarter concentrated higher volumes of investments.

Additionally the normalization of market behavior demands gradually an increase in disbursements to expand our plant capacity, and also to modernize our production processes in Brazil and overseas. With that I will close and we will turn the call back to Andre.



the storage system of energy in batteries of NPS in the US that can bring good prospect in the future for the growth of WEG, and even more synergy to our renewable energy solutions like wind, solar and also electric traction.

The second the purchase of Geremia Redutores that will complete our portfolio in the reducer business, following on our strategy to offer complete solutions in a larger range of products.

Finally profitability measured by EBITDA margin and our continuous focus on ROIC will be the main drivers for 19. Even with an expectation of growth the pace of growth in revenues will decelerate in 19, especially because of a lower project portfolio in renewable generation, as wind.

As you all know these businesses have operating margins that are lower and therefore we expect an improvement in the mix of products sold that together with the best outlook for other businesses will positively contribute to our EBITDA margin and maintenance of ROIC for the remainder of the year.

We are going now to start with the Q&A session.

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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 withdraw your question from the list press star two.

Our first question comes from Ricardo Alves from Morgan Stanley.

Mr. André Luís Rodrigues – Managing Director Financial Superintendent

Thank you Paulo. Before we open for Q&A I would like to reinforce some recent accomplishments and the prospects for the year of 19. Well, the first thing is that we announced last week the acquisition of two new businesses: the first words the purchase, the purchase of



Mr. Ricardo Alves – Morgan Stanley

Good morning Andre and Paulo, thanks for your time. I have two questions, both in GTD. The first is more objective: this level of BRL 500, 520 million if I am not mistaken that you delivered in the quarter as part of already the deceleration, now the drop in wind that everybody is expecting and a bit more volatility in T&D do you think we can work with this level along the year, or from what I understood in your release you still have something of wind that is going through the results and perhaps we should work with something like 400, 450 if it would make a bit more sense? So a bit focus more on GTD for this first question.

And then about solar energy more specifically could you please give us the breakdown in solar for what is distributed? I believe it is going to constant; but I just wanted to check on that, and the bit more color in terms of solar farms. If I am not mistaken you would deliver them by June and what would be their contribution today and if you have in your pipeline other projects like this to as of June makeup your portfolio once again, thank you very much.

Mr. Paulo Polezi – Finance and Investor Relations Officer

Hi Ricardo good morning. I am going to start with wind, GTD and then André is going to complement. Wind alone well, we have to talk about GTD as a whole in her results. As you very well mentioned we had about 520 million. The wind had a considerable share in this amount. It will reduce along the year, this is information that we have been providing, and will continue until next year.

We prefer you to look at WEG GTD for the year of 2019 in consolidated numbers, mature businesses and other sources of energy, biomass, hydro plants. They will continue to grow along 2019 and so this is a positive trend. So when you look at GTD in Brazil you have to consider at distribution and transmission that recovered sales along the year of 18, this recovery will continue along 2019; and finally solar that we can answer in separate, but it is important for you to see the whole thing.

We tend to see GTD along the year as growing. Of course there is going to be a step along the year because wind is coming out; but we expect a recovery. It is hard to give you a hard number, if it is going to be below 520. We started 1Q TY with BRL 470 million and so we are going to have some volatility; but we wish you to look at WEG's GTD as a whole, not only wind alone, and the trend is of growth along the quarters.

Mr. André Luís Rodrigues – Managing Director Financial Superintendent

And this is Andre Rodrigues. One thing before answering the question on solar is that in recent years we have given great visibility in terms of quantities for new businesses in renewable energy, wind and solar. They were new businesses that contributed toward the growth of revenue significantly.

Now we are going to disclose information as we do with all WEG's businesses. So let us talk about solar plants and distributed plants. We signed for large projects, six solar farms were delivered in 2018 and two are to be delivered in 1H 19. We are almost completing the negotiation of a third projects still for this year. Because it is the beginning of the year the prospects are positive we can say, because there are still projects farm auctions of 17 and 18 in the market that may bring positive prospects for the future.

When we go to distributed generation you will remember, WEG has been in the market since 2011 and we are expanding our network of certified installers, we have more than 300 now. And the demand for this project has excelled our expectations we have been saying. So we have very good prospects for the coming years. And differently from solar plants is that margins here are very good and compatible to other WEG's businesses. So this is what we have today for the portfolio and what we can say about solar.

Mr. Ricardo Alves – Morgan Stanley

Okay it is very clear thank you Andre, thank you Paulo as well.



Operator

Our next question comes from Lucas Marchiori from Banco Safra.

Mr. Lucas Marchiori – Banco Safra

Hello everyone good morning, thanks for the call. I have two questions, the first Andre in your presentation you talked about the two acquisitions of last week. I would like to know a bit of your strategic view, first the US for the storage of energy in batteries. This this application more for urban mobility, electric cars? Is it more for hybrid energy, solar farms together with wind energy? Or is it something more directed to Brazil or more of a global product?

And Geremia Redutores well, you have a very large portfolio of reducers today. So is it something to get to a group of clients that you did not have before? So I would like to understand a bit more about the two acquisitions.

And the second if you could give me the percentage of domestic production that is exported. So how much of Brazil's total production is being exported? Thank you very much, these are my two questions.

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

Hi Lucas thanks for your question. Okay let me talk a bit about strategic views and I am going to start with the battery storage energy system, NPS. This is the strategic value and the opportunity that this business brings for us to be a relevant player in a business that is just starting to develop worldwide. What is important is that right now numbers are not really significant. This is a project that is still under development, it is a new reality that is starting for us abroad to be implemented later on in Brazil.

So for now I already answered part of your question. Our view is that this is not going to be a local business, but rather WEG's global business. Today the market that is most evolved is the United States. Last year we announced the supplying to the city of Vermont. Vermont is a city that is conducting a project on storage based on batteries and we have than a small portfolio to develop new projects, so far and the United States.

The applications of the storage business are quite complementary to what we have been developing in terms of renewable energy. For example solar. You have solar generation and the sun is not shining all the time, the wind is not blowing of the time; so you can store this energy and use it at peak times or peak consumption.

So you already mentioned electric cars and as I said you can work with intermittent sources like solar and wind, and you also have a safety system for the distribution and transmission systems. So the projects that we are developing in the US is that - and electric traction is very important, because the use of a fast charge station in the beginning we know that the networks are not going to be in place and the solution can help.

And another thing that is very important is that this type of application finds a solution of what to do with electric car batteries. You know that they have a useful life of 5 to 7 years, but they can be reused for another 10 to 15 years in the battery energy storage. So it is a business that is complementary to what WEG offers, but it is more long-term and it will start outside Brazil.

Geremia Redutores is a company that was founded in 1973. It is a reference in its market in terms of portfolio and quality products and it really comes to expand the offer of WEG-CESTARI. You know, WEG-CESTARI has small reducers, motor reducers; but it is focus is more mid and large industrial reducers, and with Geremia we included mega-reducers. Geremia works with small reducers as well and so it is complementary. It comes to strengthen our presence in the reducers market, as I mentioned again complementary to our portfolio and it will increase our competitiveness compared to global players that are already in Brazil. So I think they were acquisitions that were very important to the company's strategy as a whole.

Mr. Lucas Marchiori – Banco Safra

Okay very clear.

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

The second part of your question on the percentage that in the end of the year was produced in Brazil and exported. So just as a reminder the number was 28% compared to net revenue in 2017 and in 18 of course there was a major impact of the exchange variation. So



this number gives an increase that is proportional to what we saw in the external market.

But we had a balance of what is sold, produced and sold in Brazil, especially in GTD and produced and sold overseas because of the increase in capacity. Altogether consider it, we went up to 30%, so slightly better, almost flat compared to the previous year.

Along the time this is something that we have been improving. There were times that other segments were more relevant in the past, and because of a specific drop of one segment the other segment kind of step up for us not to affect our numbers. So even with the reduction of wind for 2019 we do not see anything that is really going to change our trend of showing appealing numbers in terms of return on capital invested.

Mr. Lucas Marchiori – Banco Safra

Okay thank you Paulo and Andre.

Mr. Bruno Amorim – Goldman Sachs

Thank you. Just a follow-up thinking of the company as a whole. We saw since the slide of 15, 16 and we have been seeing growth in the company's top line for the last two years, and I suppose that operating leverage has contributed for your ROIC go from 13 to 17.5% that you delivered in 18.

Operator

Our next question comes from Bruno Amorim from Goldman Sachs.

Do you still have room for expanding your ROIC and margins as a whole by means of operating leverage or are you already using your full capacity given the strong growth of recent years? What can you say about that?

Mr. Bruno Amorim – Goldman Sachs

Good morning everyone. I have two questions that are follow-ups really in terms of the split of energy. I would like to understand what would be the impact of the reduction in revenue coming from wind projects. I understand that the segment has lower margins, lower invested capital, ROIC is good even with lower margins because we have lower invested capital. But can you mobilize the capital that is invested in the business? Because you are going to have a drop in revenues that is significant.

Mr. André Luís Rodrigues – Managing Director
Financial Superintendent

We want to continue to have an appealing ROIC as it was this year, in line or even above the objective that we had within the company. You ask if there is room to develop. Well, we always worked very hard to work with working capital; sometimes we have to invest. We are growing abroad, we have to invest a bit higher to support our growth.

And second what can you say with regards to the ROIC of the winter division? Is it similar to the average of the company or is it not? I understand you have lower margins and lower capital investment; but in the end of the day is the ROIC the same, higher or lower than the average of the company?

There are always opportunities improve margins and we are going to continue working on that; but our objective is to maintain interesting levels as we delivered this year. It is going to continue to be attractive to everyone.

Mr. André Luís Rodrigues – Managing Director
Financial Superintendent

Okay Bruno. Well, wind energy we have always mentioned that the return on capital invested is above company average, because WEG did not have to make strong investments to work with the business. Now if the share of wind will have a negative impact to the company well, we always work for the other businesses to offset any drops.

Mr. Bruno Amorim – Goldman Sachs

Okay thank you very much.

Operator

Our next question comes from Felipe Vinagre from Credit Suisse.



Mr. Felipe Vinagre – Credit Suisse

Good morning everyone. I have two questions changing topics above revenue, first revenue overseas. You grew 14% in local currency and you also talked about again share. I would like to know what you expect from now one. You are with the good backlog; are you going to continue with the levels of 4Q?

And in transmission the last news is after the auctions that we had recently is that you already had a backlog of BRL 500 million, if you can see if it has increased and what kind of ramp up our we going to have in terms of revenue for 2020.

Mr. André Luís Rodrigues – Managing Director Financial Superintendent

Hi Felipe. We have the prospect of in 2019 to continue to grow at the base of 2018 overseas, and why are we saying that? Well first there are two segments that we always talk about as being relevant, relevant for WEG outside of Brazil, oil and gas and mining that are in the process of recovery, and we see signs that there is a resumption and steel, pulp and paper and energy generation abroad.

And we never stop. We are opening other operating fronts and commercialization in other countries as in Asia, Africa, the Middle East. For instance TGM has a leading position in South and Latin America, but we still have opportunities in the rest of the world. So for the development of TGM out of the market in which we are leaders we might have opportunities to grow.

Another example is that we are doing very well in low voltage motors in China. We have new plant, we started to produce in Rugao in 2016 and now we are making new investments to increase the capacity of Rugao's plant. China is growing more than 20% in dollars and that shows our successful strategy outside Brazil. That is why we believe that 2019 may bring good prospect for growth in the external market.

Mr. Paulo Polezi – Finance and Investor Relations Officer

Felipe good morning this is Polezi. As for backlog we have to look at but our profile was like in this area and what it is going to be from now one. In last years we had

always had a balance between revenue from generation of energy, a mother part for the industry and another part for renewable energy. Last year the share of distributors has gone down significantly. The main player in the market is less active, especially state owned companies are a lot less active.

On the other hand it was renewable energy that took this vacant space. WEG has solutions of substations and transformers in many of these projects. For 2019 we see the same prices should go on, growth and the addition of new orders because of the auctions. So this is already starting to appear along the year, more specifically in 2H and with all that we are going to have a little bit more robust growth in the level of two digits in the area of T&D. So what is really different is the auctions that we already had an orders are going to start more to 2H TY.

Mr. Felipe Vinagre – Credit Suisse

If you allow me just two very quick questions, interest rates and income tax. They see that we prefixed rates interest rates are going down; do you think this line is going to get better or worse? And in terms of income tax if you think you are going to keep the levels of 18 or even better because you are increasing your mix overseas compared to the domestic mix.

Mr. Paulo Polezi – Finance and Investor Relations Officer

Hi Felipe let us talk a bit about financials. I always like to start by saying the following: WEG is quite different from other companies and that helps our business units, which is our financial flexibility. What is that? We have a solid balance sheet with cash liquidity and this is a must to us. The opportunities that we have to raise credit below market costs are no longer available; on the other hand especially in Brazil we are having the best time in terms of low-interest rates in history.

All that together we still have access to the main structures for financial leverage and we are going to probably continue net debt/cash ratios that are suitable or positive and we will support companies growth, this on the one hand.

Downside leverage and debt overseas. We saw an increase in interest rates in emerging markets and mature markets, Libor for instance went up and we have some leverages in Mexico, South Africa and Colombia. All that gives us a bit more financial expenses. Along the



year we are going to work to reduce this leverage in the external market, so we are working today with a best case scenario of having neutral financial results along the year. We do not know when we are going to be able to zero the debts abroad or change them for cheaper debt; but we are working to have breakeven point in 2019 or a neutral point in 2019.

Mr. André Salgueiro – Investor Relations Manager

And just to add in terms of income tax we do not have expectations in changing any of the benefits that we have, interest on capital or others. There is always this mix between Brazil and overseas and so you might have minor changes; but in the basic scenario we are not going to show anything much different in terms of effective rate for 2019.

Mr. Felipe Vinagre – Credit Suisse

Okay thank you very much.

Operator

Our next question comes from Augusto Ensiki from HSBC.

Mr. Augusto Ensiki – HSBC

Well thanks for taking my question. I have a quick question about nonrecurring numbers of 26 million. In the material fact you had mentioned 46; has the amount changed or you are going to have an extra 20 for the next quarter?

Mr. Paulo Polezi – Finance and Investor Relations Officer

Hello good morning. This question has to do with our announcement of November. The total agreement was BRL 46 million divided into installments, two parts: one point is what is not operating expenses about BRL 20 million. It was already entered, booked in results of 4Q and 26 million is monetary correction. Since it started to

be calculated back in the 90s that was booked into financial results and that is why we had unfavorable financial results. So 46 altogether, 26 in financial result and 20 in the liner mentioned.

Mr. Augusto Ensiki – HSBC

Okay thank you very much.

Operator

As a reminder if you want to ask a question just press star one.

We are now closing the Q&A session. We are going to turn back the call to Andre Rodrigues for his final considerations. Please Mr. Andre you may go on.

Mr. André Luís Rodrigues – Managing Director Financial Superintendent

Well once again thanks very much for joining us in this conference call. Even starting the year with the drop in the wind portfolio we have expectation of growing our business in Brazil and overseas. With that we are going to improve our operating margins and we are going to keep return on capital invested as WEG has been presenting, with an attractive number four 2019 as well. Good morning everyone and see you in our next audio conference.

Operator

WEG's audio conference is now closed. We thank you very much for joining us and wish you a good day.