

WEG S.A.

1st Quarter 2019 Earnings Results Conference Call

April 25, 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  
Manager

## PRESENTATION

**Operator:** Good morning and welcome to the WEG conference call to release results of 1Q19.



We would like to inform you that we are broadcasting this conference call accompanied by the slides at our investor relations site at the address [ri.weg.net](http://ri.weg.net). After the conclusion the audio will be available at our IR website. Should any participant require assistance during the conference call please press star zero to reach the help of the operator.

## DISCLAIMER

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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.

These statements involve risks, uncertainties and the use of assumptions, as they relate to future events and, as such, depend on circumstances that may or may not be present. Investors should understand that the 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.

Standards and criteria applied in the preparation of information

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.

In addition, the financial and operating information included in this results discussion are subject to rounding adjustments and, as a result, the total value presented in the tables and graphs may differ from the direct figures that precede them.

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.

Any forecasts contained in this document or forward-looking statements made during the conference call regarding future events, business outlooks, operational and financial projections and goals and the future growth of WEG are based on beliefs and expectations of the management at WEG and based on information currently available. These forward-looking statements involve risks and uncertainties and therefore dependent circumstances that may or may not occur.

Investors should understand that general economic conditions, industry conditions and other operating factors could affect the future performance of WEG and delete to results that differ materially from those expressed in these statements. This conference will be made in Portuguese with 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.

You may proceed Mr. Andre Rodrigues.



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

Good morning to all of you. It is a pleasure to be with you once again for the results of 1Q19.



To begin with the highlights net operating revenues grew 15% vis-à-vis 1Q18 reaching 2.9 billion. We also presented a growth of 22% in EBITDA that reached 462 million with margin improvement that grew 0.8 p.p. reaching 15.7%. Return on invested capital reached 18% showing one more quarter of evolution and returning to the levels observed before the global crisis in 2009.



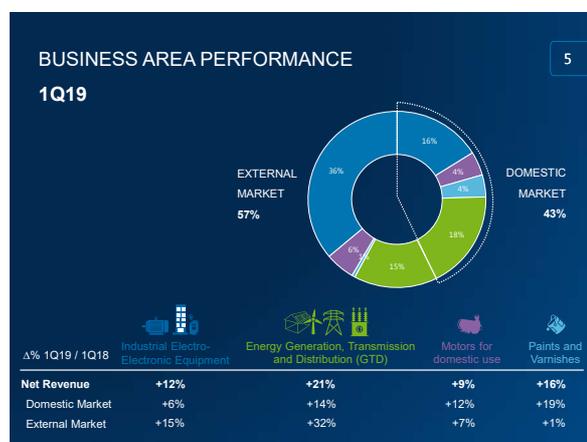
We will have more details on ROIC that presented a growth of 1.5 p.p. vis-à-vis 1Q18 reaching 18%. Operational profit after taxes explained by growth of revenue and improvement in operational margin more than offset the increase in capital invested. This is a reflects of a combination of our strategy of the development of new businesses with a return on invested capital along with discipline in the use of

capital shown through the management of working capital and the optimization of our investment program.

I would now like to give the floor to Paulo Polezi.

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

Good morning to all of you. We go on to slide number five to present the evolution of the different business units.



We begin with the industrial electro electronic equipment in Brazil, where the short cycle equipment continues to show growth. We also had an increase in the share of revenue in long cycle equipment, especially electro centrals and automation panels. The search for equipment for capacity expansion projects or brownfield and new investments, greenfield was better than expected at the beginning of the year.

The GTD area had a growth of revenue in Brazil, although there was a lower share in wind generation projects, which is something we had anticipated. The positive highlight is the solar generation business, especially distributed generation. The TD business also contributed positively this quarter with improvement in business dynamics in distribution transformers in renewable energy parts.

In domestic use motors we also had growth of revenue because they are short cycle in characteristic and this business depends on the economic performance and especially on consumption, and we now observe signs of recovery and economic resumption.

The paints business had significant improvement in some areas such as mining, metal structures and the white line.



Abroad the sales of electro electronic equipment continued to focus on short cycle products, where we have made strikes through our extension of product line in gaining share in the market. We have built new plants and we see good demand for long cycle products, with good outlook especially in the industries of oil and gas, pulp and paper, infrastructure and mining.

In the field of GTD the greatest contribution was in the field of transformers with a growth at all operations abroad with a highlight for the consolidation of the new transformers company in the United States.

In motors for domestic use the revenue continues to show the impact already observed in the last quarter with low were order intake in the local market in China, the week development of the operations in Argentina because of their local problem.

Now in paints once again there was a drop in revenues in the foreign market because of the difficulties in Argentina.



On slide number seven we show you the investments of the last quarters. In 1Q19 investments reached BRL 91.8 million, 31% destined to Brazil, 69% to our production units abroad with a growth vis-à-vis 1Q18 due to the expense of investments in the first foundry of WEG outside of Brazil, which is in the final phase of construction in Mexico. With this I would like to conclude and return the floor to Andre.



We see the evolution of EBITDA in 1Q19 with great highlight when we compare this to the previous quarter. We had significant growth of 21.6%. EBITDA margin ended the quarter at 15.7% with an evolution of 0.8 p.p. vis-à-vis 1Q18. This is a reflection of an improvement in the profitability of operations abroad, margin gains and a more favorable mix in Brazil because of lower revenues in wind generation and lower operational margins.

### Recent Achievements

- Carbon Clean 200 - WEG was ranked among the top 200 publicly traded clean energy companies in the world

### Outlook 2019

- Improvement in EBITDA margin supported by mature businesses in Brazil and units abroad
- Lower revenue growth due to fall in wind projects backlog
- Another year of ROIC favorable performance

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

Thank you very much Paulo and before we go on to questions and answers I would like to reinforce our outlooks for the rest of the year. At the beginning of March we stated that WEG was once again considered among the main companies in clean energy throughout the world. We are part of the Clean 200 ranking made up of 200 companies and there are other Brazilian companies that are part of this. This shows our commitment with the best sustainability practices.



Now even that we have the expectation of lower revenue growth in 2019 because of the drop in our project portfolio in wind generation, we do expect to have an improvement in the operational margin, of EBITDA and this because we expect a better performance of mature businesses in WEG Brazil and better profitability in the operations abroad, and we will also have an improvement in the value of return on invested capital during the year. We will now go on to the question-and-answer session.



## Q&A Session

### Operator

Ladies and gentlemen we will now go on to the question-and-answer session. Should you wish to pose a question please press star one.

Our first question comes from Tiago Casceli, you may proceed sir.

### Mr. Tiago Casceli – Credit Suisse

Good morning to all of you, thank you for taking my question. I have two questions, the first referring to the market abroad where we see good outlooks during this quarter. I would like to hear about your outlook if there is much space in your in the year to increase your share, to obtain new customers or to increase the volumes with the present-day customers, and which was the impact on your EBITDA margin in this 1Q19?

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

Tiago this is Andre speaking to you, thank you for the questions and I would like to refer to your expectation on the market abroad and Paulo will refer to the impact in IFRS 16. Now we are thinking of the slowdown in the economy abroad and this has been disclosed broadly; but we do not feel this. We continue to show significant growth in the main regions and we have carried out was to increase our market share through be mature businesses of WEG and by launching new products in a diversity of markets - and that is why we deemed that our performance will continue to remain above that of the market.

In the foreign market we should also reinforce that we are predominantly stronger with short cycle products that have a portfolio of 3 to 4 months. Now with this portfolio that we have enhanced at present we are still not feeling this reflects abroad; but despite this WEG is working with the winning strategy when it comes to the launch of new products and we are exploring markets where we have strong participation in Brazil and abroad. Of course we have a very good reputation and all of this has shown good results.

### Mr. Tiago Casceli – Credit Suisse

Thank you Andre.

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

Tiago good morning this is Paulo. The IFRS 16, the new standard adopted in Brazil beginning in January and we have a new explanation on our site, all the details are there. This represents a value of BRL 12 million approximately in our calculation and you can calculate this yourself. It represents 0.3 p.p. for the company, an increase of 0.3 p.p. Once again you have all the details in our explanation number three on the slide.

### Mr. Tiago Casceli – Credit Suisse

Thank you very much.



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**Operator**

The next question is from Alexandre Falcao from HSBC.

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**Mr. Alexandre Falcao – HSBC**

Good morning to all of you. I have two questions, the first if you could speak about the situation abroad. When you think of the USD denomination perhaps the situation is not what as robust as it was. I would like to gain a better understanding of what you are doing with this in terms of outlooks. The local currency, the denomination in USD.

The second question refers to Brazil. When it comes to short cycle especially in terms of investments your results showed that there has been a drop in GDP, a drop in demand. Are you beginning to feel this contraction in demand? Thank you very much.

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

Falcao thank you very much for your question, let us continue on then. We have to pay attention to the short term analysis because WEG is exposed to a series of currencies and not only the USD and that is why we always present the growth of local currencies and the local currencies, a basket of currencies in the countries in which we operate had a growth of 8.1% during the quarter, this is positive.

When it comes to the question in terms of operations in China and Mexico let us begin with China. China is following the same trend we observed in the last five years for industrial motors with low voltage. There has been a growth of two digits in the last five years for our performance and it was not different in 1Q, and because of this we increased the capacity of the Rugao plant to be able to continue on with the growth that WEG has there.

We have found other opportunities of entering the market through a unit to act in the Chinese market. We have had some difficulties that we have reported because of some local issues of the market and the commercial war with the United States; but the general balance continues to be very positive and WEG continues to invest in China.

Now Mexico tends to follow the same trend with lower growth rates compared to China. Now the first point we continue on with our verticalization strategy in Mexico and in 2Q we will conclude our investments in the foundry. Mexico will be ever more verticalized, will be more competitive in terms of prices.

And the business of transformers did not show a good performance, it was somewhat below the previous year because of electoral uncertainties in Mexico and because of the issue of the United States, the trade barriers and the ongoing discussions. What we are reinforcing for this 1H is an improvement in the sales area in transformers coming out of Mexico for the domestic market as well as for exports. Therefore, these two countries that are strategic countries outside of Brazil where we concentrate our industrial production, are having a very positive evolution.

In terms of the short cycle we like to always be very cautious about developments in Brazil, because this gradual resumption of the economy will depend on the economy, but this also holds true for the short cycle. When we speak about short cycle we are referring to motors and automation. These are projects that have a shorter period of three or four months, but as a mentioned those that we have in hand have shown positive performance during 1Q.

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**Mr. Alexandre Falcao – HSBC**

Thank you very much.

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**Operator**

The next question is from Lucas Marchiori from Safra Bank.

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**Mr. Lucas Marchiori – Banco Safra**

Good morning to all of you and thank you for the call. I also have two questions. We see the revenue in energy growing year after year in the domestic market, perhaps more than was expected. There has been of course a drop in wind energy, but there has been a growth. Now I would like to understand where this improvement or enhancement in revenues is coming from, why this is more than he had expected and this is my first question.



The second question you mentioned the improvement in the competitive environment in Mexico. Is this going in accordance to what you had planned when you acquired the company?

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

Lucas thank you very much. I will begin speaking about GTD and the results for this quarter. We had a very great expectation once again due to the fall of the wind portfolio that had already begun; but during this quarter we were able to report the growth of 13.6% higher than that of 1Q18.

Now what happened? The first positive aspect is solar generation that became ever more relevant for the company in 2018 and continues to grow. It is adding quarters to our portfolio and the outlook for this business is still positive, especially in the distributed energy that has been showing continuous growth in the last few months. So this has fully offset the fall in wind energy and even more so I would like to remind you that in 2019 the GTD part has made a positive contribution. The outlook is for this contribution to continue. We do have improvement in the dynamics of substations in our deliveries will begin to take place in 2019 and 2020, and of course we will be able to recognize these results.

We should recall that in 2018 we had a 1Q that was sometime weaker in terms of transformers and we had a smaller solar energy and distributed energy base and in 2018 we only had one month of TGM that was consolidated only in March. So this explains the good performance we had in 1Q.

Now when we speak about WEG Transformers USA things are very positive. From the viewpoint of sales the transformers unit of WEG abroad had a better performance of all of the units, but in the United States we have a very good order portfolio, WEG and WTU, once again this is a highly renowned company in terms of transformers and the good news is in this 1Q the results have already become positive. The expectation was that this would happen throughout 2018. We also mentioned that the internal inflation in the United States and commercial issues were very strong and would not allow this to be possible, but we had announced that we had the initiative to increase prices because of inflation and we have seen the good results already in 1Q. Now the EBITDA is positive and the operational results of this company are positive as of this 1Q.

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**Mr. Lucas Marchiori** – Banco Safra

Thank you very much.

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**Operator**

The next question is from Bradesco BBI.

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**Mr. Victor Mizusaki** – Bradesco BBI

Good morning and congratulations for your results. I have two questions, one is a follow-up on the question made by Lucas about GTD, if you could give us some more color in terms of backlog for solar energy and if based on backlog we can say that GTD could become a reason of concern and as of revenue we see that this will not be the case.

And the second question you mentioned that some clients are beginning to court prices for new projects. Could you give us some more color in terms of the potential revenues that would arrive from these contracts?

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

Victor, Polezi, good morning and let us begin speaking about GTD and solar energy. Now the backlog it is very difficult to speak about details, but I can comment about some points. Well we can advance that in terms of solar plants and distributed energy in 1Q we had results similar to those we had last year and for the time being our deliveries will concentrate during this 1H. And I would like to remind you that since 2016 WEG has already delivered for solar plants, Malta in Paraiba as well as four other projects. Until mid-2019 the forecast that we have us to deliver another three: Esmeralda, Pernambuco; Sobrado, Bahia and another one in Paraiba.

To conclude our vision is that this business has become ever more relevant in the GTD field and the expectations are positive for the rest of the year. We still have projects that are open due to the auctions and this will enable us to capture something, but this is still part of our outlook. In terms of distributed energy GTD we had stronger growth and where does this growth come from? A very



sound network of integrators with national coverage and this has led to a great number of orders. And finally this does not exactly pertain to backlog; but distributed energy is this segment where we are able to obtain better margins and this helps us to recover margin when it comes to distributed generation.

The question is if there will be improvements in the long cycle in Brazil. We already perceive that we are receiving quotes for long cycle equipment and in the same period last year we did not have this request for quotes. Some of present have interesting amounts linked to the pulp and paper segment and especially mining and this is favorable.

We will begin the year with a better outlook and Andre at the beginning mentioned that we have to be very cautious. For the time being there are a few projects, but last year we had an absence of projects and so we do have a better outlook for long cycle equipment if compared with 2018.

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**Mr. Victor Mizusaki** – Bradesco BBI

Thank you.

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**Operator**

The next question is from Rogerio Araujo from UBS.

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**Mr. Rogério Araújo** – UBS

Good morning to all of you and thank you for taking my question. I have only one question in terms of your ROIC. We have seen an increase in the last quarters, but in the last quarters there has been an appreciation of the BRL and we continue to see an increase.

You spoke about the transformers that had positive results in 1Q and I would like you to give some more color in terms of what explains this improvement on the return on invested capital and how far we can go. I recall that during the crisis you did not imagine you would reach return to a level where you are; but the investment in long cycle equipment are still missing and I would like to know what will happen with these investments in long cycle equipment and when this will materialize and which will be the levels that it can attain if we imagine a return of the long cycle projects.

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

Rogerio good morning this is Andre Salgueiro. Just to give it about ROIC we do have several impacts and it is very difficult to explain the reasons. You mentioned them very clearly, there is an improvement in the margin in our operations abroad and this of course can be helpful; and additionally we begin to see a resumption of the long cycle equipment in Brazil in industrial projects in specific segments like pulp and paper and mining and we also see an improvement in GTD of what we deemed to be long cycle. We believe that when the market is in a better situation we will be able to recover those margins and this will enable us to continue to grow the ROIC in the long-term.

It is difficult to give you a metric, what we can say is that this year we should return to levels very similar to those of last year. This is our expectation at present for 2019.

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**Mr. Rogério Araújo** – UBS

Thank you very much, that is exactly what I wanted to hear.

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**Operator**

We would like to remind you that should you wish to pose a question please press star one.

The next question comes from Joao Noronha from Santander Bank.

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**Mr. Joao Noronha** – Santander

Good morning to all of you, thank you for taking my question. There have been several questions in terms of backlog and GTD. Now if you could refer to the orders that have come out of the transmission auctions at the end of 2016 and 2017, if you could give us a more qualitative answer, the results are above or below what you had expected in terms of the auctions? Thank you.



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

Good morning. Yes we can give you more color. When it comes to the auctions we would like to remind you that we had some contracts. Our clients were awarded for lots in 2017, 2018, there are several open contracts in the market and WEG would have the opportunity of working with other players. It is also possible to work in other fronts for example by selling equipment directly in terms of other orders and other opportunities. And with all of this we have a very clear vision of our order portfolio that has been improving quarter after quarter. We do not think we will have great leaps from one quarter to the other, but instead a gradual improvement year after year. Year after year we have observed significant improvement semester after semester.

Evidently we have to be somewhat cautious. Some of those who were awarded the auctions offered very low prices and this could have an impact on the supply, and once again we will have to be very selective to guarantee the best returns possible. We do not necessarily want to have a higher number of orders. We are working very well in this in our expectations in this field are quite positive not only for this year but for the coming years as well.

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**Mr. Joao Noronha** – Santander

Thank you very much.

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**Operator**

The next question is from Guilherme Mendes from J.P. Morgan.

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**Mr. Guilherme Mendes** – JP Morgan

Good morning and another question going forward. Well we are speaking about a better growth and improvement in the EBITDA margin and much more.

How do you consider WEG going forward thinking of the 2020, 2021 horizon? Are we going to have slower growth? Because we see that the improvement in

margin is taking place at a faster pace in 2018. What is your outlook for the medium term?

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

Guilherme let's speak a bit about expectations in the long-term - but once again would have to be very cautious when it comes to these expectations. In 2019 what we expect is the following: that the EBITDA margin will be better than in the previous years. We were at 15.1%, 15.2% in the last two years because of the crisis that had an impact on the EBITDA margins.

Now this year we have everything to have a better performance and we have two quarters, LQ 18 and this 1Q with better results. Now the expectation for the resumption of the economy in Brazil means that we should have an improvement in margins and the more mature businesses of WEG Brazil. As Paulo mentioned we will have a more consistent delivery of equipment this year and the improvement in the profitability of businesses abroad.

We have to speak about the US as well as Mexico, where we are concluding an important part of the verticalization in Mexico but of course will lead to improvements and once again capacity we are better able to dilute costs and we can improve our margins.

The expectation to improve the margin of the mature operations in Brazil depends on the market as a mentioned in our portfolio of wind projects will be delivered this year and we do hope to have a better return on capital. Now this is what we are expecting for this year. The margins of WEG can continue to improve during the coming years? Yes, the response to this is positive. As Rogerio stated in his question the long cycle in the right economic conditions could further improve.

Now those who were at WEG Day know that we have a new program for the improvement of costs presented in Brazil and we are implementing the same program outside of Brazil as well. So there is an expectation that improvements will continue, but we cannot state which will be the levels of our margins. We too have years where we have a better performance, other years when we continue our process of investments or acquisitions with a small drop perhaps, but I believe that the company will always present attractive figures, which is the main indicator for the company.

Now we cannot state we will have an improvement quarter after quarter. Perhaps the figures will be



somewhat lower than 2018, it is possible; but we want to remain at attractive levels once again.

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**Mr. Guilherme Mendes** – JP Morgan

Thank you very much, thank you very much for your response.

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**Operator**

We would like to remind you that should you wish to pose a question please press star one.

We continue with Lucas Barbosa from Morgan Stanley.

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**Mr. Lucas Barbosa** – Morgan Stanley

Good morning Andre, Paulo, thank you for the presentation. My question is a follow-up on the discussion on distributed generation. Could you give us more color in terms of what you are expected this year? And if you could speak about competitors that are involved in this distribution network, thank you very much.

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

Lucas good morning this is Paulo. What we can advances that we have a highly positive outlook in distributed generation. This is something that has gained relevance and in so far as solar energy has volatility, one quarter may be stronger and another may be weaker, but we tend to have a more stable and constant base for distributed generation and we will get to the point where distributed generation will become more important than the solar plants.

The outlook nevertheless is positive. WEG carried out very good work in terms of training the network and installation. We have focused a great deal on this and the financial results continue to be attractive. The payback for distributed generation is highly favorable and therefore several companies are working in terms of cost reduction because of the present situation of the country. Cost reduction has good results.

So we are increasing our ability to assemble our export contracts for the long-term getting ready for a more prolonged improvement in distributed generation. As you can see the company is ready to grow more in this sector not only this year but going forward as well.

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**Mr. Lucas Barbosa** – Morgan Stanley

Thank you Paulo. So when it comes to competition have you observed any differences, any new players in the market or not?

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

Lucas this is Andre Salgueiro. Yes we do have other players in the distributed generation market, WEG is not the only player; but as we have been in Brazil for some time, as we are and acknowledged company, we do have a competitive edge. But of course we have to think about the size of the market and yes, we are competing with other players in the market.

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**Mr. Lucas Barbosa** – Morgan Stanley

Thank you.

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**Operator**

At this point we would like to close the question-and-answer session. I would like to return the floor to our speaker for the closing remarks.

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

Well thank you very much once again to all of you for your participation and what can I say at the end of this quarter? We ended this quarter based on the confirmation of our expectation and we have had a very good return on invested capital. Now even though we will have less growth during the year in wind generation for example, we do want to reach better operational margins compared to previous years and deliver and attractive return on invested capital. Once again thank you for your participation and have a good day.

WEG S.A.

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Transcript of the simultaneous translation from Portuguese into English



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**Operator**

The conference call for WEG is closed. We would like to thank all of you for your participation and have a nice day.

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