

Q1 2020 Earnings Call

Company Participants

- Andre Luis Rodrigues, Chief Financial and Administrative Officer
- Andre Meneguetti Salgueiro, Manager, Investor Relations
- Paulo Geraldo Polezi, Finance and Investor Relations Executive Officer

Other Participants

- Alexandre Falcao, Analyst
- Catherine Kiselar, Analyst
- Gabriel Rezende, Analyst
- Lucas Marquiori, Analyst
- Rogerio Araujo, Analyst
- Unidentified Participant
- Victor Mizusaki, Analyst

Presentation

Andre Luis Rodrigues {BIO 17964192 <GO>}

(Starts Abruptly) But we are observing the recommendations of social isolation. First, we are going to start talking about the operating income, which grew 26.7% compared to the first quarter 2019. The performance of our businesses proved to be positive in practically all areas. We observed a continuation of the improvement trend in Brazilian industrial activity and good performance in the GTD area, both in Brazil and abroad. It is important to remember that our operations in China were impacted this quarter due to the fact that the plants were shut down in February due to the initial outbreak of the new coronavirus, COVID-19 in the country.

We have provided details on the performance of our businesses and the impact of COVID-19 below. Another highlight of the first quarter was EBITDA which grew by 34.1% and reached BRL619 million. The EBITDA margin increased 1 percentage point reaching 16.7%. Throughout the presentation, Paulo will give more details about this variation. Finally, we had another quarter of ROIC evolution as we will see on the next slide, which grew by 2.7 percentage points over the first quarter 2019 reaching 20.7%. The consistency of this indicator in recent quarters reflects the improvement in our operating performance demonstrated by the combination of revenue growth and expansion of the EBITDA margin.

I now turn the floor over to Paulo Polezi for him to continue.

Paulo Geraldo Polezi {BIO 19468811 <GO>}

Good morning, everyone. Moving on to Slide 5, where we present the evolution of the business areas in different markets. Starting from the area of industrial electronic equipment in Brazil, we observe a positive performance of short cycle equipment, which has been showing continuous improvement in the last quarter. We have also seen an improvement in demand for long cycle equipment partly driven by deliveries related to important projects in last year in segments such as pulp and paper, oil and gas and mining which concentrate most of our new investments in Brazil.

The GTD in Brazil continues to be the main highlight of our results were all of the businesses, with the exception of wind generation showed significant revenue growth in this quarter. We highlight solar generation again especially distributed generation which maintained the good performance of the last quarters. Also the transmission and distribution businesses, where the important deliveries related to transmission auctions held in recent years. I would like to point out that starting this quarter, we will start calling the old engine for appliances of -- and domestic appliance of -- domestic appliance reflecting more appropriately the product portfolio of this business area. In this area, we continue to observe the good performance in revenue presented during the year 2019 in Brazil, effect linked to the higher demand in segments such as washing machines and air-conditioning.

In the Paints and Varnishes business, the good performance of the quarters reflects an increase in participation in new markets such as agriculture implements and automotive refinish as well as civil construction and industrial maintenance projects. In the foreign markets, our performance in industrial, electrical and electronic equipment was also positive despite showing a slower growth rate already observed in the previous quarter due to the slowdown in global growth. On the other hand, long cycle equipment continues to perform well. We have important deliveries for projects in oil and gas, mining, water and sanitation segments such as the new refinery project in Oman. In the GTD area, the largest contribution was from the transformer business in the US and Mexico with synergies between these operations working as planned.

In commercial engines and appliances, the performance of the foreign market was impacted by COVID-19 especially in China where the signs of slowdown presented in the last quarters were intensified the temporary stoppages of our factories, due to the determinations of the local government. In Paints and Varnishes, revenue growth is the result of constant search for new customers and gaining market shares in Latin American countries.

Slide 6 shows the evolution of EBITDA in the first quarter 2020 where we presented a growth of 34.1% in relation to the first quarter 2019. The EBITDA margin ended the quarter at 16.7%, showing an increase of 1 percentage point in relation to the first quarter 2019 among the reasons for margin improvement already mentioned by Andre. We highlight the margin gain in mature businesses in Brazil, mainly in the industrial engine and GTD businesses and the better profitability of operations abroad with the highlight on the T&D operations in the USA and Mexico.

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Finally on slide 7, we show investments in CapEx of the last quarters. In the first quarter of this year, investments reached BRL123.7 million, 54% of which went to Brazil and 46% to production units abroad, showing growth in relation to the first quarter 2019 mainly in investments in Brazilian operations to improve processes, productivity gains and IT investments.

With that, I turn the call back to Andre.

Andre Luis Rodrigues {BIO 17964192 <GO>}

Thank you, Paulo. In this particular quarter, we would like to take the opportunity to talk about our actions and perspectives for the year in face of the COVID-19 pandemic. On slide 9, we report important actions implemented in order to preserve the safety of our employees and other stakeholders, as well as the continuity of our business. We have implemented three levels of crisis committee, one executive, one which is operational and the other in units abroad. We have adopted a series of protective and social distancing measures to preserve the safety of our employees and other stakeholders.

It's important to mention here that all the learnings we had with the H1N1 pandemic in 2009 in Mexico and with the COVID-19 at the beginning of this year in China. Measures and protocols adopted at the time were used again and were essential to preserve the continuity of our business, but mainly the health and safety of our employees. We have adopted mechanisms of collective vacations, our banks and work from home in all possible situations in order to respect the rules of social distancing and adapt productive capacity to the new level of demand. In addition, we have adopted a series of measures aimed at mitigating the impact of the crisis of -- on our business as much as possible, such as constant monitoring of our client's credit risks, financial cycle optimization measures, review of annual investment plans, maintenance of strong cash position, which will be further clarified by Paulo in the next two slides.

To conclude this slide, I would like to comment that we are implementing a series of initiatives to help this chain of solidarity that was formed around the fight against COVID-19 among which adaptation of our factory in Jaragua do Sul to produce pulmonary ventilators for use in hospital ICUs by patients recovering from the disease. The production of alcohol gel, hand sanitizers in our paint and varnish factory for internal use and donations to hospitals in the region.

Paulo please.

Paulo Geraldo Polezi {BIO 19468811 <GO>}

Thank you, Andre. Moving on, on Slide 10 we would like to highlight the company's solid cash position. We ended the quarter with BRL3.4 billion in gross cash and even discounting a 100% of our indebtedness, we still had a net cash of BRL908 million at the end of the quarter. This situation allow us to go through the period of macroeconomic deterioration caused by COVID-19 in a balanced way.

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On Slide 11, we presented the evolution of our indebtedness represented by the net debt to EBITDA indicator, which has been negative in the last four years, reflecting our net cash position. It's important to note that we do not have relevant debt maturing in the next 12 months and we do not have any pressures from financial covenants since only a very small portion of our indebtedness has this type of contractual clause. This combination of solid balance sheet and low indebtedness should ensure favorable conditions for us to be able to withstand this crisis.

I end my participation here and give the floor back to Andre for his final remarks.

Andre Luis Rodrigues {BIO 17964192 <GO>}

Before moving on to the question-and-answer session, I would like to comment on our prospects for 2020 which are very different from the ones we had the visibility of in the beginning of the year. It's worth mentioning that we are still in the middle of the pandemic, experiencing a scenario of many uncertainties and making any kind of projections would be hasty at this point.

Within the visibility we have, we can say that demand for short cycle equipment will drop in the coming months. This should happen in a general way in all product lines and in all regions. On the other hand, long cycle products, which we have built an important portfolio in the last quarters tend to suffer less in the short-term. The projects in our portfolio continue their schedules and should bring stability to this part of our business at this time around.

We also expect pressure on our operating margins. Restrictive measures adopted by some countries and the drop in demand should influence this indicator in the months to come. All this leads us to prioritize the preservation of the company's cash at this time.

Finally, I would like to reinforce our differentiators and which is a way to refer to our competitive advantages and they are important in term of crisis such as the one we have experienced. For example, our revenues and customer base are diversified both geographically and in customer segments, give us the opportunity to take advantage of sales opportunities wherever they are available. Our production is distributed in several locations, thus, reducing our operational risks. We have a very competitive cost structure based on vertical integration. Our solid balance sheet and financial flexibility guarantees favorable conditions for us to face this crisis. In addition, throughout our history, innovation and new product development have always been important to our long-term growth. We will continue with our focus new businesses such as electric traction, energy storage and digital businesses can bring growth opportunities in the medium and long-term.

I end the presentation here. Please, operator, you can proceed to the question-and-answer session.

Questions And Answers

Operator

Ladies and gentlemen, we are now going to start the Q&A session. (Operator Instructions)
Our first question comes from Victor Mizusaki with Bradesco BBI.

Q - Victor Mizusaki {BIO 4087162 <GO>}

Hello, good morning. Congratulations on your results. I have two questions. The first one is the -- related to the construction of backlog for long cycle products. Could you provide us more color as to the magnitude of this backlog six months, one year? And the second question related to WEG's strategy as to cash position -- net cash position as you have experienced in the end of last quarter. Can you provide more information on this?

A - Andre Luis Rodrigues {BIO 17964192 <GO>}

Hello, Victor, thank you very much. This is Andre Rodrigues speaking. Let's talk about the long cycle backlog. We have already mentioned that part of it was built in a moment before the crisis. So T&D transformers in Brazil, let's have the situation back in 2017, this is the situation we had. So both in Brazil and abroad, our long cycle portfolio. When we talk about short-term, let's talk about one year, okay, just for us to be on the same page. So it continues to be very favorable. Something else which is also positive is that both in Brazil and abroad in all the units, where we do not have lock down for long cycles, we are not operating normally because it's just natural to have a high level of absenteeism.

Why is that? Because in some regions such as the United States, the employee can declare that he is in the risk group and he will not go to work in Brazil. The transportation - public transportation may not be working. So the employee is not able to reach work. So if there are no cancellations, all will continue normally and we will make some advances in the following year. When we talk about the strategies, and people ask a lot about this and we understand that this is not our moment to be aggressive as to M&A. Considering that we always analyze the business opportunities, we understand that this is not the right moment, we have a very important business which is being analyzed by Cadi [ph]. But we are announcing any major opportunity because our focus is on small opportunities to complete this strategy that we announced related to digital businesses.

What may happen in the short term, our small-sized acquisitions, which are not material in terms of value so that we can continue our strategy related to digital development. This momentum requires a lot of integrations and we need to undergo a process, so that we can understand the company when if we would like to make acquisitions. So this is not the right moment and for the short term, we are not communicating anything -- anything else, other than what I mentioned.

Q - Victor Mizusaki {BIO 4087162 <GO>}

Another point that you mentioned, considering that there will be no cancellations or delays in the agreement. Is there any clause related to cancellations that would entail fines that may lead to a situation when the cancellation could become prohibitive or are the contracts, more flexible for the clients.

A - Andre Luis Rodrigues {BIO 17964192 <GO>}

Victor, all clients will have the force majeure clause, the Act of God clause. And this is something that has not been used yet, but it's very normal that at the time of pandemic, delays may happen related to the crisis. But this is not something that concerns us at this time. What we have always mentioned, Victor, is that this is a crisis with no precedent. And the snapshots are taken on a daily basis. So what we say is, what we can see that is happening today. So the scenario may improve or deteriorate. So this is the situation that we have at this time.

Q - Victor Mizusaki {BIO 4087162 <GO>}

Okay, thank you.

Operator

Our next question comes from Rogerio Araujo, UBS.

Q - Rogerio Araujo {BIO 17308156 <GO>}

Good morning. Congratulations on the results for the quarter. I have two questions. The first is related to the level of exchange rate and we understand that WEG gains in March because of the rate, considering the cost of the exchange rate. My question is, after the crisis, if the dollar rate is at a lower level, how do you see the competitiveness of the company? And do you think that you would decrease the price in dollar, so that you would increase share or increase the volume? How do you see competitiveness considering the exchange rate? And the next question will be asked later.

A - Paulo Geraldo Polezi {BIO 19468811 <GO>}

Good morning. Thank you very much for your question. This is Paulo speaking. As for the currency rate, since we became international some years ago, we understand that the currency rate has very positive role, a very important impact without any doubt. As a specific value, you mentioned 3%, it's a calculation that is difficult for us to make. We understand that there are many currencies that have to be considered although the dollar is more -- the most important. So this rate may help us in some aspects and may not be so favorable in some other aspects. So the answer for you will be, yes. We have this positive exchange rate factor on the result. But the calculations are very complex.

And we do not make this calculation so often. Devaluation puts the company into a differentiated competitive level. And of course we can use this advantage provided by the currency rate for our strategy. And the company has already done this previously in other situations not only in relation to the exchange rate, but also other situations related to the balance sheet and the working capital. And if the company is well positioned, the company can use the good opportunities. So this is all part of our business vision and use all the opportunities that are around related to the currency rates.

Q - Rogerio Araujo {BIO 17308156 <GO>}

Okay, perfect. My second question is related to -- may be using China as a proxy, considering of what we can expect. So to which degree the income of China has dropped in a rough manner of course? And do you think this can lead a way for what you expect in other regions? And what's the percentage of your income is connected to long cycle and short cycle? Thank you.

A - Andre Meneguetti Salgueiro

Hello, Rogerio. This is Andre Salgueiro, speaking now. Honestly, I do not know whether China would be a good proxies for us to do the analysis of other operations because China started in the worst of crisis. And when we -- when it came back, the rest of the world was operating nearly normal. So China had a very abrupt situation when we had the complete lock down and also the Chinese New Year. And at that period, the income nearly became zero. And when the economy went back to business, we lost some days of income. But when the operations in China started their operations, the level was close to pre-impact of the crisis. And the Chinese internal market is doing well. What we can say is related to the import of China and this was caused by downturn in other regions of Europe when the situation started to get worse in the areas such as Spain or Italy.

So I don't think it's a very good idea to use China as a proxy for us. And what you expect for our operations in Brazil. What we understand there is that the recovery is going to be different from what happened in China. As to the second part of your question associated with the long and short cycles. What we can say is, that on average, we have about 35% or 40% connected to long cycle and the rest in a consolidated manner is connected to short cycle.

Q - Rogerio Araujo {BIO 17308156 <GO>}

Okay, Andre, it was really very clear. Have a good day everyone.

Operator

Our next question comes from Lucas Marquiori, BTG Pactual.

Q - Lucas Marquiori {BIO 17907247 <GO>}

Hello, good morning everyone. Thank you very much for the call. So my question is related to the follow-up of the previous questions. I would like to understand the level of utilization of the factors in Brazil. We heard that the State of Santa Catarina is returning before other areas. And we -- we would like to know what was the capacity reached by the plant? So could you share with us what's the level of utilization of the plants? And I would like to know what is this new WEG knowledge this new platform? And I would also like to know if it would encompass all the digital development? Or is this part of the digital or is this something different?

A - Andre Luis Rodrigues {BIO 17964192 <GO>}

Hello, Lucas. Thank you very much for your question. The capacity of utilization of the plants changed a lot. It's more relevant to talk about the future than the past. And we also understand that it depends a lot on the countries. Some countries are in total lock down,

for example, Argentina, India. The volume of production in those countries are not so relevant anyway and the information that reached -- that has reached us is that the beginning of the May, many of the activities will be recovered, will be resumed.

As I said before, this is the -- the utilization capacity is more connected to absenteeism. So the situation is not critical. As you commented about the Government of Santa Catarina, there was a decree. And the operations were forced to work at 50% of the personnel, so that the social isolation measures would be guaranteed. In order to minimize this impact, this is what we did because we would lose 50% of our production capacity. So in some areas we adopted the third shift. In Jaragua do Sul, we have -- usually have two shifts. So increased another shift. So we were able to reach a capacity of 70%. If we consider the absenteeism, as I said, it all depends on the segment. And here in Santa Catarina where you are allowed to restart operations, but you have to take measures in order to ensure the safety of our operators. In some cases, we have reached 80% because of the absenteeism. And cycle -- long cycle, it has reached about 90%, industrial, electric equipment is a bit below. But this is -- depends on how the portfolio will behave in the future considering that the portfolio of short cycle product is very short.

And we are -- we have a focus on engines and appliances and we can see that many stores stopped and so many clients went on collective vacations, they've reduced their working hours. So we are making adjustments now that will start to materialize next week. And we are making adjustments of reduction of 25% or 30% of the working hours. But this is connected to engines for appliances specifically. And WEG knowledge is a platform, the OT of our company, which is associated with cloud computing, because we have to have a platform where we can have all our apps, especially when we are talking about integrated solutions. It's a tool, that's very easy to use. Our systems allow clients to develop their customizations from simple to more complex applications. And with this, we allow the possibility of collaborative systems and environments and solutions that are related to the digitalization of our processes and gains in efficiency. This is part of our strategy to increase the force of our digital businesses.

Q - Lucas Marquiori {BIO 17907247 <GO>}

Okay, Andre. Thank you. Have a good day.

Operator

Our next question comes from Alexandre Falcao, HSBC.

Q - Alexandre Falcao {BIO 5515455 <GO>}

Good morning. Thank you very much for the call. Are you handling credit? Are you imposing more restrictions? And what about those who use the clause of force majeure, Act of God? So how is this playing out in Brazil? Are you giving any special attention to those contracts? And the other question is related to distributed generation. It's my understanding that this business has come to a stop. Do you believe that depending on the measures to be adopted, may be a lock down, is there any perspective that we will not be able to resume the level you were before the pandemic?

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A - Paulo Geraldo Polezi {BIO 19468811 <GO>}

Falcao, good morning. Thank you very much for your question. This is Polezi speaking. As for the credit, we had higher demand in Brazil. So this effect was mostly felt in Brazil in comparison to other areas. So it may happen something abroad, but we didn't have an experience of that so far. As for our customer portfolio, those who came to us to ask for a delay in payment, are those operating in the short-cycle segment. And for each case, we adopted the procedure. In general, the person would ask for a delay in the payment, and we would evaluate on that case-by-case basis if there was a real need for a delay. We also observed what the government provided as an aid to inject working capital. So we would check if the clients were diligent accessing the real sources. But we had a demand of BRL120 million as delay in payment for April and May. So we were able to meet 50% of this demand using technical criteria. So this was one way that WEG used. We were very careful because we understand that companies are facing difficulties during the crisis. So we are working on a case-by-case basis.

The second part of your question was related to distributed generation, solar energy. Let me tell you what happened last quarter. It was a quarter that was performing well. The first quarter of 2020 had a very good performance, better than expected. And we would like to say that Distribution Center in Tajaé [ph] is supporting all the demand for the first quarter. And integrating network that was developed by our company covers the whole territory of Brazil. And this also helped the business to be favored in this period. Considering this COVID-19 scenario and all the restrictions that were imposed by the health authorities and the government, they are going to cause more difficulties for -- in the months to come. This is for sure.

And these are the points of attention. The supply chain was our initial concern considering start of the outbreak in China. And in this regard we didn't have a relevant impact. So supply has not been affected. In April, we can see that the orders are not being placed and since our installators are not making the proper installations. And due to the lockdowns, our -- the businesses that have been closed, some installations are not being carried out. And considering the nature of short cycle segments and also the impact by COVID, and with a higher dollar rate, these all impacts prices. And this is a point that has to be observed by players. And also there is a surplus of energy in the market. So some volatility can be expected for the months to come, since we saw that there was a relevant drop in the spot price. We have to be attentive to all those points and we have to say, Falcao, that the strong balance sheet of WEG will help us go through this difficult times different from some of our competitors. And we might come out of the crisis continuing supporting our clients.

Q - Alexandre Falcao {BIO 5515455 <GO>}

Wonderful. Just a last follow-up. In relation to the operations abroad, I believe that South Africa is completely closed. So how do you see your operations, especially in relation to Europe? Do you consider concentrating, or considering decreasing production or using all those resources and having Brazil as a hub? What I would like to understand really is, if or when we will see any measures being taken more specifically, concentrating businesses in Brazil considering that you have an export platform in Brazil, which is very robust?

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A - Andre Luis Rodrigues {BIO 17964192 <GO>}

This is Andre Rodrigues, speaking. Yes, this is something that is always considered at WEG. But it's also important to say that we always talk about Brazil, let's consider engine. We have three major production complexes. Brazil is the one which has most vertical structure, more advantages in terms of cost. Mexico has become more relevant in the process. If you asked this question five years ago, may be I would look more specifically to Brazil. But things are changing, but China and Mexico considering the verticalization initiatives, these are also production complexes that show important productivity. So, we say that WEG's advantage is the modular expansion. And we expand to other places in a very easy manner when the trade war between China and the United States favored us. When we started the discussion of whether there is an increase in tariff in Mexico, what can we do.

We also mentioned that in the short term we would be able to make changes in the production to move the mix of production to the United States or to Europe. So, when we talk about Brazil, Portugal, for example, which is concentrated in a specialty engine, explosion engines, this is always taken into consideration. We always try to use all those analysis to understand where we can ensure more competitiveness. The good news is this, Brazil has this advantage but WEG does not look only at Brazil. This is also valid for long-term segments. There is a router which was produced in India, the starter was produced in Brazil and the other part was produced in Minneapolis. So, WEG uses all cost, productivity, labor in different countries, so that we can be ever more competitive.

Q - Alexandre Falcao {BIO 5515455 <GO>}

Okay. Okay, perfect. Thank you.

Operator

Our next question comes from Gabriel Rezende, Bradesco BBI.

Q - Gabriel Rezende {BIO 20589376 <GO>}

Hello, good morning. I have a question in relation to the international market. When we consider dollar, we see that it was basically flat considering that this is just a small portion. And we also see that there was no effect of coronavirus in other region. And I also would like to make a follow-up on the previous question related to the retail segment. In addition to the effects of distribution and the limited mobility, how do you see the market in terms of economic deterioration, and smaller GDP [ph] unemployment rate is increasing and clients are less prone to make those kinds of the installations.

A - Paulo Geraldo Polezi {BIO 19468811 <GO>}

Good morning, Gabriel, this is Polezi. I'm going to answer your first question. We could not understand your second part of the question. You talked about GTD or GD? Oh, distributed energy, okay. Going back to dollar, we had a growth of 1.4% in the external market, the foreign market 1.4%. When we make adjustments according to the local currencies, we come to 5.5%. So some factors also influenced this. So the dollar and against dollar parity was a bit limited. And one of the factors that influenced was the 10

days stoppage in China that caused the impact in the operation. And the second point is that we saw global deceleration and this affects our company in the short-cycle segment. So we had the combination of those two factors that made our growth in dollar terms, more slowly. And what was different was the long cycle business's activities that made the strike a better balanced.

A - Andre Meneguetti Salgueiro

Gabriel, this is Andre Salgueiro. Good morning. In relation to the distributed generation I understand there are many details to consider, but I understand that your question was focused on the business activity. For us, it's difficult to measure what will be the impact on the economy. We are attentive to projections of banks of focus report. And it's just natural that in a scenario like this, segment where you have investments, which are relatively high, kit for household would be -- reach even BRL20,000. And we understand the demand is going to be as expected of course. But it's something which is really difficult to measure what the impact will be and for how long it will last. Another important point that Paulo mentioned was the energy price and the currency rate. With a lower energy price in the spot market, the payback of those projects are tend to be longer. So you have the influence on the decision of the customer. And the solar panels price will also be increased. So all of those variables will have to be analyzed, because the client will take all this into consideration. And something else that was mentioned by Paulo was the WEG balance are in structured. And how prepared we are to face up this market. And we are going to be available and attentive to take on all the opportunities that come up. And we do not believe that our competitors will have the same opportunities. And this is something we'll be focusing on at this moment.

Operator

Our next question comes from Catherine Kiselar with Banco do Brasil.

Q - Catherine Kiselar {BIO 20979709 <GO>}

Hello, good morning. Congratulations on your results and thank you for the opportunity of asking a question. My first question is related to the impact in relation to the cancellation of our -- of auctions that was announced in March. And considering the COVID crisis, will there be any change in your positioning? Will you increase or decrease in some aspects or even considering the reduction of Jaragua factory since it has been allocated for the production of ventilators. I would like you to make some comments about those.

A - Andre Meneguetti Salgueiro

Hello, Catherine, good morning. This is Andre Salgueiro, speaking. In relation to the auctions, both generation and transmission auctions and they were planned to take place this year and they were delayed and it's just natural that a moment like this considering all of the uncertainties, the government decided to delay all those processes. So they are likely to happen any time in the future when the scenario finally stabilizes. So in practice, what we are going to have is fewer opportunities of projects in the medium and long terms in relation to the auctions for also assets. And also in relation to transmission and distribution, there is something which is important to mention which is as follows. Some

years ago, we had generation and transmission auctions that happen recurring both for transmission lines and contracted energy at a higher level since 2016, 2017, 2018 and 2019. We understand that the market has full of opportunities related to those projects.

And we talk about T&D and our portfolio is very robust. But also in relation to generation, both solar and wind energy involves different projects that have not -- projects that are in the pipeline and they have not decided who the suppliers are going to be. And the decision is going to be made according to regulatory terms. And we see that the spot price is lower, the exchange rate is also impacting project. And it's natural that we see clients delaying those. But all of those are likely to happen within the regulatory deadlines. And in relation to this year, we are going to expect those to resume next year, profiting [ph] in relation to their occupancy of Jaragua do Sul plant.

Jaragua do Sul is a place where we produce long and short cycle products and our portfolio is good and our production has nearly reached the normal levels. And we also had collective vacations when we made adjustments to the capacity in Jaragua do Sul plant and as for commercial engines and appliances. If we come to a point when this drop is very significant and WEG will start making changes in the shift, so that we can make adjustments to our demands. As for pulmonary ventilation, this is something very specific. If the rate of occupancy was complete. And if it was necessary to produce pulmonary ventilators, we would hire more people, we would look at this anyway. And when all the stores started, we heard many comments that, this was a simple piece of equipment to be produced. What I can say, it's not simple equipment. Some components are not produced in Brazil. And because we have our tooling active -- a tooling area within our plant, we were able to replicate some parts, but there are some special valves that cannot be produced here, and they have to be imported from China. So we made an agreement with the supplier that, reduced so that we could have this technology transfer. So right now we have more than 100 people working on this project, so that we can meet the demand of the government in relation to the requirement of those pulmonary ventilators.

So something important to mention is that we are making equipment to save lives. And the question is how do you test that? We have to import four machines from the United States that test efficiency of those pieces of equipment. So you cannot simply have the equipment leaving the factory and send it straight to hospital to serve somebody who is between life and death. So this is for you to understand the level of serum is that we are adopting, so that we can make it happen. And we are expecting parts to reach our plants, and so that we can start supplying those pieces of equipment.

Q - Catherine Kiselar {BIO 20979709 <GO>}

Congratulations on your initiative. And in relation to the second question, it's also specific to the oil and gas area. So do you intend to intensify your operation with oil and gas? And what are the future impacts that you expect in other sectors considering the commodities that were also impacted by COVID. Could you provide some light on this, related to the impact on WEG's impact. I would like to thank you for that.

A - Paulo Geraldo Polezi {BIO 19468811 <GO>}

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Catherine, good morning. Paulo Polezi here. Let me talk about oil and gas. We have always been on look out of all the trends, of all the commodities somehow. So we have to understand the behavior of the market in all of those. As for oil and gas, we have to mention some points. First, the quarantine reduced the consumption of oil. Our can contracts were not made and the historical prices came to a low. And the market is very uncomfortable. And this movement is going to affect the small and medium sized operators those who are more exposed to shale gas and some of our short cycle products and the demands can be divided into maintenance and small sized operations and also production. So this is -- these are the areas where the effect is going to be the biggest. And there are projects we are less the sizes, these are long cycle projects and they are likely to continue.

We do not believe they are going to be canceled. We understand the decision making process is focused on the long term. So all of those work with the risk factors and with a long-term view. So we believe that those projects are going to be preserved. And it's difficult to give an accurate answer to you because we have to observe the low demand scenario, not only in the United States is where we have relevant presence, but across the world and some projects have not been computed because the companies were still in negotiations and these may be delayed to a later phase in the future. So it's important to remember that all those commodities, dynamics, volatility and everything have all been part of our company's history.

It's not the first time this happens, we had similar crisis such as that in 2008 and also Brazilian crisis in 2016 and somehow we overcame the crisis. Brazil and our company overcame the prices and we understand that our presence is much more robust, much more encompassing. And this allows us to have businesses with some clients where we didn't have chances in the past.

Q - Catherine Kiselar {BIO 20979709 <GO>}

Okay. Perfect. Thank you very much for your answer, and congratulations again on your results.

Operator

Our next question comes from (inaudible) from Credit Suisse.

Q - Unidentified Participant

Hello, good morning. Thank you very much for the presentation. I have a quick comment to make. When we look at the operating expenses by nature, we can see that cost with labor, increases in BRL100 million, and that affects negatively, the EBITDA margin. Could you provide some light on this point, please?

A - Andre Meneguetti Salgueiro

Hi, Lucas, good morning. This is Andre Salgueiro speaking. Yes there is impact personnel, we also -- we always have an adjustment of the salary of employees in the beginning of

the year. And in this quarter, we had the retirement of some of our directors and this was something non-recurrent in associated with the processes that I mentioned. Thank you.

Operator

(Operator Instructions) We end the Q&A session now. I would like to turn the call back to Mr. Rodrigues for his final consideration.

A - Andre Luis Rodrigues {BIO 17964192 <GO>}

Once again, thank you very much for attending our conference call. I hope you are all healthy. Please observe the social isolation requirements. Thank you very much and see you next call.

Operator

WEG's conference call has come to an end. We would like to thank you for your participation and have a good day.

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