

Q1 2019 Earnings Call

Company Participants

- Andre Luis Rodrigues, Vice CEO, Chief Administrative & Financial Office, IRO and Member of Executive Board
- Andre Salgueiro, Investors Relations Manager
- Paulo Geraldo Polezi, Chief Finance & Investors Relations Officer & Member of Executive Board

Other Participants

- Alexandre Falcao, Analyst
- Guilherme Mendes, Analyst
- Joao Noronha, Analyst
- Lucas Barbosa, Analyst
- Lucas Marquiori, Analyst
- Rogerio Araujo, Analyst
- Unidentified Participant

Presentation

Operator

Good morning and welcome to the WEG conference call to release results for the first quarter 2019. 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 ir.weg.net. After the conclusion, the audio will be available at our IR website.

(Operator Instructions) Any forecasts contained in this document are forward-looking statements made during the conference call regarding future events, business outlook, 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 depend on 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 lead 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 from Jaragua do Sul, we have Andre Luis Rodrigues, the Financial and Administrative

Director Superintendent; Paulo Polezi, the Financial Officer and IR Officer; Wilson Watzko, Controller; and Andre Salgueiro, the IR Manager at WEG. You may proceed, Mr. Andre Rodrigues.

Andre Luis Rodrigues {BIO 17964192 <GO>}

A good morning to all of you and it's a pleasure to be with you once again for the results of the first quarter 2019. To begin with the highlights, net operating revenues grew 15% vis-a-vis the first quarter '18, reaching BRL2.9 million. We also presented a growth of 22% and EBITDA that reached BRL462 million with a margin improvement that grew 0.8 percentage points, reaching 15.7%.

Return on invested capital reached 18%, showing one more quarter of evolution and reached into the levels observed before the global crisis in 2009. We will have more details on the ROIC that presented a growth of 1.5 percentage points vis-a-vis the first quarter '18, reaching 18%. Operational profit after tax as explained by a growth of revenues and an improvement in operational margin more than offset the increase in capital invested. This is a reflex of the combination of our strategy of 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.

Paulo Geraldo Polezi {BIO 19468811 <GO>}

A good morning to all of you. We go on to slide number 5 to present the evolution of the different business units. We begin with Electro-Electronic Industrial Equipment in Brazil where the short cycle equipment continues to show growth. We also have an increase in the share of revenues in long cycle equipment, especially in electrocenters and automation panels. The search for equipment for capacity expansion projects, both 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 GTD business also contributed positively this quarter with an improvement in the business dynamics and distribution transformers and renewable energy parks. In domestic use motors, we also had a growth of revenue. Because they are short cycle in characteristics, this business depends on the economic performance and especially on consumption and we now observe signs of recovery and economic resumption. The paint business had a significant improvement in some areas such as mining, metal structures and the white line.

Abroad, the sales of electro-electronic equipment continue to focus on the short cycle projects where we have made strides through our expansion of our products line and gaining share in the market. We have built new plants and we see a good demand for

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long cycle projects with good outlook especially in the industries working in oil, gas, pulp and paper, infrastructure and mining. In the field of GTD, the greatest contribution was in the field of transformers where the growth had all the operations abroad, with a highlight for the consolidation of the new transformer company in the United States.

In motors for domestic use, the revenue continues to show the impact already observed in the last quarter, with a lower order intake in the local market in China, the weak development of the operations in Argentina because of their local problems. Now in paint, once again there was a top end revenues in the foreign market because of the difficulties in Argentina.

We see the evolution of EBITDA in the first quarter '19 with a great highlight when we compare this to the previous quarter. We had a significant growth of 2.16%. The EBITDA margin ended the quarter at 15.7%, with an evolution of 0.8 percentage points vis-a-vis the first quarter '18. This is a reflection of an improvement in profitability of operations abroad, margin gains and a more favorable mix in Brazil because of lower revenues in wind generation and lower operational margins.

On slide number 7, we show you the investments of the last quarter. In the first quarter of 2019, investments reached BRL91.8 million, 31% (inaudible) to Brazil, 69% to our production units abroad with a growth vis-a-vis the first quarter '18 due to the advance 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.

Andre Luis Rodrigues {BIO 17964192 <GO>}

Thank you very much, Paulo. And before we go on to question and answers, I would like to reinforce our outlook for the rest of the year. At the beginning of March, we stated that WEG was once again consider them on the main companies in clean energy throughout the world. We're part of a clean 200 ranking made up of 200 companies and there are other Brazilian companies that are part of this. They shows our commitment with the best sustainability practices.

Now, even though we have the expectation of lower revenue growth in 2019, because of that drop in our project portfolio and wind generation we do expect to have an improvement in the operational margins of EBITDA. This because we expect a better performance of matured businesses in WEG in 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.

Questions And Answers

Operator

Ladies and gentlemen, we will now go on to the question-and-answer session. (Operator Instructions) Our first question comes from (inaudible). You may proceed, sir.

Q - Unidentified Participant

Hey, 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 outlook and during this quarter, I would like to hear about your outlook if there is more space during 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 first quarter of 2019.

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

Now, Thiago, this is Andre speaking to you. Thank you for the questions and I would like to refer to your expectations on the market abroad and Paulo will refer to the impact in 2016. Now we're thinking of a slowdown in 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 work to increase our market share through the mature businesses of WEG and by launching new products in a diversity of markets and that is why we deem that our performance will continue to remain above that of the market.

In the foreign market, we should also reinforce that we're predominantly stronger with short cycle projects that has a portfolio of three to four months. Now with this portfolio that we have in hands at present, we're still not feeling this reflex abroad. But despite this, WEG is working with a winning strategy when it comes to the launch of new products and we're exploring markets where we have strong participation in Brazil and abroad, of course we have a very good reputation. All of this has shown good results.

Q - Unidentified Participant

Thank you, Andre.

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

And thank you.

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

Thiago, good morning. This is Paulo, the series '16, the new standard was adopted in Brazil beginning in January and we have a new explanation on our slide, all of the details are there. This represents a value of BRL2 million approximately in our calculation and you can calculate this yourself. It represents 0.3 percentage points for the Company, an increase of 0.3 percentage points. Once again, you'll have all of the details in our explanation number 3 on the slide.

Q - Unidentified Participant

Thank you very much.

Operator

The next question is from the Alexandre Falcao from HSBC.

Q - Alexandre Falcao {BIO 5515455 <GO>}

Good morning to all of you. I have two questions, the first, if you could speak about the situation abroad. When you think of this and the dollar denomination, perhaps the situation is not as robust as it was. I would like to gain a better understanding of what you're doing with this in terms of your outlook, the local currency, the denomination in dollars. The second question refers to Brazil. When it comes to the short cycle, especially in terms of investments, your results show that there has been a drop in GTD and the drop in demand. Are you beginning to feel this contraction in demand? Thank you very much.

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

Falcao, thank you very much for your question. Let's continue on then. We have to pay attention to the short-term analysis because WEG is exposed to a series of currencies, not only the American dollar and that is why we always present the growth of local currencies. And the local currencies, the 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's begin with China.

China is following the same trend that we observed in the last five years for industrial motors with a low voltage. There has been a growth of two digits in the last five years for our performance, things were not different in the first quarter. 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 the second quarter we will conclude our investments in the foundry. Mexico will be ever more verticalized, we 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 electro uncertainties in Mexico and because of the issue of the United States, the trade barriers and the ongoing discussion.

What we are reinforcing for this first semester 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 have been 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 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, three or four months. But as I mentioned, though that we have in hand have shown a positive performance during the first quarter.

Q - Alexandre Falcao {BIO 5515455 <GO>}

Thank you very much.

Operator

The next question is from Lucas Marquiori from Safra Bank.

Q - Lucas Marquiori {BIO 17907247 <GO>}

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 you had expected and this is my first question.

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

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

Lucas, thank you very much. And let's 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 a growth of 13.3% higher than that of the first quarter in '18. 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 orders to our portfolio. And the outlook for this business is still positive, especially in distributed energy that has been showing continual 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 an improvement in that dynamic of sub-stations and 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 first quarter that was somewhat 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 GTM [ph] that was consolidated on the end March. So this explains the good performance we had in the first quarter.

Now, when we speak about WEG transformers USA, it seems to be very positive from the viewpoint of sales. The transformer units of WEG abroad had a better performance, all of the units. But in the United States we have a very good order portfolio, WEG and NPS, once again this is a highly renowned company in terms of transformers and the good news is that in this first quarter the results have already become positive. The expectation was that this could 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 an initiative to increase prices because of inflation and we have seen the good results already in the first quarter. Now the EBITDA is positive and the operational results of this company are positive as of this first quarter.

Q - Lucas Marquiori {BIO 17907247 <GO>}

Thank you. Thank you very much.

Operator

Your next question is from Bradesco BBI.

Q - Unidentified Participant

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 based on backlog, we can say that GTD could become a reason of concern and (inaudible) revenue, we see that this will not be the case. And the second question, you mentioned that some clients are beginning to quote prices for new projects. Could you give us some more color in terms of the potential revenue that could arise from these contracts?

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

This is Polezi. Good morning, and let's begin speaking about GTD and solar energy. Now the backlog, it's very difficult to speak about details, but I can comment about some points. While we can advance in the terms of solar plants and distributed energy in the first quarter, we had results similar to those we had last year, and for the time being our deliveries will concentrate during this first semester. And I would like to remind you that since 2016 WEG already delivered four solid plants, once again, Malta [ph] and (inaudible), as well as three other projects until mid-2019.

The forecast that we have is to deliver another three, Geraldo, Pernambuco, (inaudible) and 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 will 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 a 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 doesn't exactly pertain to backlog, but distributed energy is the segment where we are able to obtain better margins. And this helps us to recover margins when it comes to distributed generation. Now, if you could repeat your second question, please?

Q - Unidentified Participant

The question is, if there will be improvements in the long cycle in Brazil.

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

We already perceive that we will receive in quotes from long cycle equipment. In the same period last year we did not have these requests for quotes. Some at present have interesting amounts. They are linked to the pulp and paper segment, and especially mining. And this is favorable. We will begin the year with a better outlook. Andre at the beginning mentioned that we have to be very cautious. For the time being there are few projects. But last year we had an absence of projects. So we do have a better outlook for long cycle equipment, if compared with 2018.

Q - Unidentified Participant

Thank you.

Operator

The next question is from Rogerio Araujo from UBS.

Q - Rogerio Araujo {BIO 17308156 <GO>}

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 quarter, but in the last quarter there has been an appreciation of the real and we continue to see an increase. You spoke about the transformers that have had positive results in the first quarter. And I would like you to give some more color in terms of what explains this improvement of return on invested capital and how far we can go.

I recall that during the crisis you didn't imagine that you would return to a level where you are. But the investments in long cycle equipment are still missing and I would like to know what will happen with this investments in long cycle equipment and when this will materialize and which will be the levels that it cannot change, if we imagine a return of the long cycle projects.

A - Andre Salgueiro

Rogerio, good morning. This is Andre Salgueiro. To speak a bit about ROIC, we do have several impacts and it's very difficult to explain the reasons. You mentioned them very clearly there is an improvement in the margins in our operations abroad. 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.

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And we also see an improvement in GTD of what we deem 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. They are all (inaudible) in the long term. It's difficult to give you a metric. What we can state is that this year we should return to levels very similar to those of last year. This is our expectation at present for 2019.

Q - Unidentified Participant

Thank you. Thank you very much. That's exactly what I wanted to hear.

Operator

(Operator Instructions) The next question comes from Joao Noronha from Santander Bank.

Q - Joao Noronha {BIO 17451608 <GO>}

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 from the transmission auction at the end of 2016 and 2017, if you could give us some more qualitative answer, if the results are above or below what you had expected in terms of the auction? Thank you.

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

Good morning. Yes, we can give you more color. When it comes to the auction, 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's also possible to work on 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 improved in quarter after quarter.

We don't think that 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 a significant improvement semester-after-semester. Evidently, we have to be somewhat cautious. Some of those who were avoided the auctions offered very low prices. This could have an impact on supply. And once again we will have to be very selective to guarantee the best returns possible. We don't necessarily want to have a higher number of orders. We're working very well in this and our expectations in this field are quite positive, not only for this year but for coming years as well.

Q - Joao Noronha {BIO 17451608 <GO>}

Thank you. Thank you very much.

Operator

The next question is from Guilherme Mendes from JPMorgan.

Q - Guilherme Mendes {BIO 20011867 <GO>}

Good morning and another question. Going forward, well, we're speaking about a better growth and improvement in EBITDA margin and much more. How do you consider WEG going forward thinking of the 2020, 2021 horizon, are we going to have a slower growth because we see that the improvement in margin is taking place at a faster pace since 2018. So what is your outlook for the medium-term?

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

Guilherme, let's speak a bit about expectations in the long term, but once again we need 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%, 15.2% in the last two years because of the crisis, that has an impact on the EBITDA margin. Now this year we have everything to have a better performance and we have two quarters, the last quarter of 2018 and this first quarter with better results.

Now the expectation for the resumption of economy in Brazil means that we should have an improvement in margins in the more mature businesses of WEG Brazil. As Paulo mentioned, we will have more consistent delivery of equipment this year and an improvement of profitability in businesses abroad.

We have to speak about the US as well as Mexico where we're concluding an important part of verticalization in Mexico that of course would lead to improvements. And once we gain capacity, we're better able to dilute our cost and we can improve our margins. The expectation to improve the margin of the mature operations in Brazil ultimately depend on the market as I mentioned. And 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're 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 do 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 can state is, we will have an improvement quarter-after-quarter. Perhaps the figures will be somewhat lower than 2018, is this possible, but we want to remain at attractive levels once again.

Q - Guilherme Mendes {BIO 20011867 <GO>}

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

Operator

(Operator Instruction) We continue with Lucas Barbosa from Morgan Stanley.

Q - Lucas Barbosa {BIO 20835372 <GO>}

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 expecting this year and if you could speak about the competitors that are involved in this distribution network. Thank you very much.

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

Lucas, good morning. This is Paulo. What we can advance is that we have a highly positive outlook in GDT. This is something that has gained relevance. And in so far as solar energy have volatility, one quarter may be stronger, 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 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 day situation of the country. Cost reduction has good results. So we're 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.

Q - Lucas Barbosa {BIO 20835372 <GO>}

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

A - Andre Salgueiro

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 an acknowledge 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.

Q - Lucas Barbosa {BIO 20835372 <GO>}

Thank you.

Operator

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

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

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 our 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 an attractive return on invested capital. Once again, thank you for your participation and have a good day.

Operator

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

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